(1)

Supreme Court, U.S.
FILED
JUN 2 1988
JOSEPH F. SPANIOL, JR.

No. 87-1245

In The

# Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

*Appellant,*

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

*Appellees.*

**ON APPEAL FROM THE COURT OF APPEALS THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN**

## JOINT APPENDIX VOLUME I

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* Attorney of Record

**The Jurisdictional Statement was filed January 22, 1988**
**Probable Jurisdiction Noted on March 21, 1988**

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## DOCKET ENTRIES

| DATE | PLEADINGS FILED |
|---|---|
| 5-14-85 | Defendants' Original Answer—Bob Bullock, Comptroller of Public Accounts of the State of Texas; Jim Mattox, Attorney General of the State of Texas; Ann Richards, Treasurer of the State of Texas and the State of Texas |
| 2- 3-86 | Both parties announced ready. Witnesses placed under rule. Opening statements. Evidence commenced. Recess at 5:10 P.M. until 9 A.M. 2/4/86 |
| 2- 5-86 | Arguments. Judgment for Plaintiff holding exemption unconstitutional. J. Dibrell |
| 3-18-87 | REVERSED AND RENDERED: Opinion by Chief Justice Shannon; dissenting opinion by Justice Carroll |
| 5- 6-87 | Appellee's motion for rehearing en banc submitted and overruled. (MO # CV-21,276) |
| 5-27-87 | Appellee's motion for rehearing submitted and overruled—substituted opinion by Chief Justice Shannon; dissenting opinion by Justice Carroll. (MO# CV-21,274) |
| 6-24-87 | Appellee's second motion for rehearing submitted and overruled. (MO# CV-21,422) |
| 9-23-87 | App writ err disp |
| 10- 8-87 | Rehearing Filed |
| 10-15-87 | Rehearing Forwarded |
| 10-28-87 | Rehearing Disp |

DEFENDANTS' ORIGINAL ANSWER

Filed, May 14, 1985

NO. 378,384

| | | |
|---|---|---|
| TEXAS MONTHLY, INC. | ) | |
| | ) | |
| Plaintiff, | ) | |
| | ) | IN THE |
| VS. | ) | DISTRICT |
| | ) | COURT OF |
| STATE OF TEXAS, BOB | ) | TRAVIS |
| BULLOCK, COMPTROLLER | ) | COUNTY, |
| OF PUBLIC (sic) | ) | TEXAS |
| OF THE STATE OF TEXAS, | ) | |
| JIM MATTOX, ATTORNEY | ) | 345TH |
| GENERAL OF THE STATE OF | ) | JUDICIAL |
| TEXAS, AND ANN RICHARDS, | ) | DISTRICT |
| TREASURER OF THE STATE | ) | |
| OF TEXAS, | ) | |
| | ) | |
| Defendants. | ) | |

DEFENDANTS' ORIGINAL ANSWER

TO THE HONORABLE JUDGE OF SAID COURT:

COME NOW Bob Bullock, Comptroller of Public Accounts of the State of Texas; Jim Mattox, Attorney General of the State of Texas; Ann Richards, Treasurer of the State of Texas, and the State of Texas, Defendants, herein, and would show the Court as follows:

I.

Defendants deny each and every allegation contained in Plaintiff's Original Petition filed herein, and demand strict proof thereof.

WHEREFORE, PREMISES CONSIDERED, Defendants pray that Plaintiff take nothing by its suit and that all costs incurred herein be taxed against Plaintiff, and for such other and further relief both in law and in equity, to which Defendants may be entitled.

Respectfully submitted,

JIM MATTOX
The Attorney General of Texas

DAVID R. RICHARDS
Executive Assistant

HARRIET D. BURKE
Assistant Attorney General
Chief, Taxation Division

/s/ David Mendez
DAVID MENDEZ
Assistant Attorney General
Bar Card No. 13932575
P. O. Box 12548
Austin, Texas 78711-2548
(512) 475-1013

ATTORNEYS FOR
DEFENDANTS

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Defendants' Original Answer has been sent certified mail, return receipt requested, to Attorney for Plaintiff, R. James George, Jr., GRAVES, DOUGHERTY, HEARON & MOODY, this 13th day of May, 1985.

/s/ David Mendez
DAVID MENDEZ

PLAINTIFF'S SECOND AMENDED
ORIGINAL PETITION

Filed, January 15, 1986

NO. 378,384

| | | |
|---|---|---|
| TEXAS MONTHLY, INC., | ) | |
| | ) | |
| Plaintiff, | ) | |
| | ) | IN THE |
| VS. | ) | DISTRICT |
| | ) | COURT OF |
| STATE OF TEXAS, BOB | ) | |
| BULLOCK, COMPTROLLER | ) | TRAVIS |
| OF PUBLIC ACCOUNTS OF | ) | COUNTY, |
| THE STATE OF TEXAS, JIM | ) | TEXAS |
| MATTOX, ATTORNEY | ) | |
| GENERAL OF THE STATE | ) | 345TH |
| OF TEXAS, and ANN | ) | JUDICIAL |
| RICHARDS, TREASURER OF | ) | DISTRICT |
| THE STATE OF TEXAS, | ) | |
| | ) | |
| Defendants. | ) | |

PLAINTIFF'S SECOND AMENDED
ORIGINAL PETITION

TO THE HONORABLE JUDGE OF SAID COURT:

Now comes TEXAS MONTHLY, INC., a Texas corporation, hereinafter referred to as Plaintiff, complaining of the STATE OF TEXAS, BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, and ANN RICHARDS,

TREASURER OF THE STATE OF TEXAS. In support of its claim, it will show the Court the following:

I.

This is a suit brought pursuant to § 112.001, *et seq.*, Texas Tax Code.

II.

On January 21, 1985 Plaintiff paid $21,137.53 in protest. On February 20, 1985 Plaintiff paid $8,982.37 in protest. On March 25, 1985 Plaintiff paid $10,073.68 in protest. On April 19, 1985 Plaintiff paid $14,118.68 in protest. On May 20, 1985 Plaintiff paid $13,606.63 in protest. On June 19, 1985 Plaintiff paid $7,994.56 in protest. On July 19, 1985 Plaintiff paid $10,582.93 in protest. On August 20, 1985 Plaintiff paid $12,763.83 in protest. On September 19, 1985 Plaintiff paid $10,406.97 in protest. On October 18, 1985 Plaintiff paid $16,086.52 in protest. On November 18, 1985 Plaintiff paid $14,333.91 in protest. On December 18, 1985 Plaintiff paid $9,020.13 in protest. A copy of each of the letters of protest are attached hereto.

III.

The taxes at issue here are sales taxes collected on the sale of magazines. The tax is imposed by § 151.051, Texas Tax Code. Magazines had been exempt from the sales tax prior to the repeal of § 151.320, by Acts 1984, 68th Leg. 2nd Called Session, p. 552, Ch. 31, art. 12, § 4 effective October 2, 1984.

## IV.

Plaintiff publishes a magazine known as *Texas Monthly* in Austin, Texas and it sells the magazine by subscription sales and single copy sales to Texas residents. There are many other magazines that sell to Texas residents. Many of those magazines do not have any offices in Texas. The Comptroller has entered into an intentional plan to collect the sales tax from only those magazines that have offices in Texas, especially magazines such as Plaintiff. The Comptroller makes no effort to collect the sales tax from companies that sell magazines in Texas, but which have no offices in Texas. Such conduct constitutes an unlawful plan and scheme of taxation that violates Article 8, § 1 of the Constitution of Texas.

## V.

The unlawful plan and scheme of taxation described in paragraph IV above also violates Article 1, § 3 of the Constitution of Texas and the Fourteenth Amendment to the Constitution of the United States.

## VI.

Section 151.312 exempts from the sales tax religious periodicals. Such an exemption constitutes an unlawful discrimination based on the content of a publication and thus violates Plaintiff's rights guaranteed by the First and Fourteenth Amendments to the Constitution of the United States and Article 1, § 8 of the Constitution of Texas.

## VII.

The collection of a sales tax on the very act of speaking and publishing constitutes a tax upon the privileges

guaranteed by the First and Fourteenth Amendments of the Constitution of the United States and Article 1, § 8 of the Constitution of Texas. In particular, the tax collection practices discriminate against in-state magazine publishers as compared to all other types of printed material in that they must compete with magazines that pay no taxes.

## VIII.

The imposition of the sales and use tax to magazine subscription sales discriminates in its operation against the magazine industry since there is no effective way to collect the tax from readers. It is a gross receipts tax in its operation as it affects magazines sold through mail subscriptions while it can be passed on and does operate as a sales and use tax for other industries. Therefore, it violates the First and Fourteenth Amendments to the Constitution of the United States.

WHEREFORE, PREMISES CONSIDERED, Plaintiff prays that it recover a judgment against each Defendant, jointly and severally, as provided by statute, for $149,107.74, plus statutory interest, costs, and such other relief at law or in equity to which it shows itself entitled.

Respectfully submitted,

GRAVES, DOUGHERTY,
HEARON & MOODY
2300 InterFirst Tower
P. O. Box 98
Austin, Texas 78767
512/480-5600

By: /s/ R. James George, Jr.
R. James George, Jr.
State Bar ID #07810000
ATTORNEYS FOR PLAINTIFF

## CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Plaintiff's Second Amended Original Petition has been mailed, certified mail, return receipt requested, to counsel of record for all Defendants, to-wit: Mr. David Mendez, Assistant Attorney General, Office of the Attorney General of the State of Texas, P. O. Box 12548, Austin, Texas 78711 on this the 14 day of January, 1986.

/s/ R. James George, Jr.
R. James George, Jr.

(p. 1) NO. 378,384

| | | |
|---|---|---|
| TEXAS MONTHLY, INC. | ) | |
| | ) | |
| VS. | ) | |
| | ) | IN THE 345TH |
| STATE OF TEXAS, BOB | ) | JUDICIAL |
| BULLOCK, COMPTROLLER | ) | DISTRICT |
| OF PUBLIC ACCOUNTS OF | ) | |
| THE STATE OF TEXAS, | ) | TRAVIS |
| JIM MATTOX, ATTORNEY | ) | COUNTY, |
| GENERAL OF THE STATE | ) | TEXAS |
| OF TEXAS, AND ANN | ) | |
| RICHARDS, TREASURER OF | ) | |
| THE STATE OF TEXAS | ) | |

STATEMENT OF FACTS

VOLUME ONE

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

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MR. ERIC G. BEHRENS,
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ATTORNEYS FOR THE PLAINTIFF

MR. DAVID MENDEZ AND MS. HARRIET D. BURKE,
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Austin, Texas 78704
ATTORNEYS FOR THE DEFENDANTS

(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered

and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

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| Plaintiff's Exhibit No. 1 | 9 | 9 |
| Plaintiff's Exhibit No. 2 | 9 | 9 |
| Plaintiff's Exhibit No. 3 | 9 | 9 |
| Plaintiff's Exhibit No. 4 | 9 | 9 |
| Plaintiff's Exhibit No. 5 | 9 | 9 |
| Plaintiff's Exhibit No. 6 | 9 | 9 |
| Plaintiff's Exhibit No. 7 | 9 | 9 |
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(p. 6) THE COURT: The Court recognizes and the State has presented its plea to the jurisdiction filed on January the 3rd for the Court's consideration, wherein it is pleading that the Court is without jurisdiction to take up paragraph eight of plaintiff's second amended original petition. The Court will take such plea under advisement, will not rule on it until a later time before I can proceed further and become familiar with the actual issues in the case. I think to take it up at this time would probably disrupt an orderly process for proceeding with the evidence in the case, and so I'm just going to take it under advisement.

MR. GEORGE: Thank you Your Honor. Let me begin with a preliminary and in the process address this issue as we go. We have a sales and use tax issue. Tax on magazine subscription sales is the issue. The tax in question was passed during the special legislative session in the summer of 1984 and became effective on October 2nd, 1984, and the taxpayer's first obligation to remit

taxes was for the quarter—the last quarter of 1984, and that tax was remitted pursuant to a protest (p. 7) letter filed that is—a copy of which is attached to the petition and—February 21st—I'm sorry—January 21st, 1985. That was drafted by Mr. Gerhart, and a copy is attached to all of our pleadings in this case and was for the sum paid at that time of $21,000, as I recall. A copy of that is attached to Mr. Mendez' plea to the jurisdiction, and I would mark that and introduce it. I believe we have a stipulation these all can be introduced.

MR. MENDEZ: No objection.

MR. GEORGE: Would you mark that Exhibit 1, please?

MR. MENDEZ: If I may, Your Honor, are we going into the evidence right now, or do we have time for an opening statement in this case, or what are we doing?

MR. GEORGE: Well, Mr.—what I would plan to do, Your Honor, is to cover the preliminaries of the protest being made and entered and then introduce the issues by referencing to the protest letters that it raised as—one, because it gives a context to plea to the jurisdiction, and two, it gives the Court the chronology of the events involved and (p. 8) the issues raised in the protest and then make my opening statement after these are put in simply because it's the easiest way.

THE COURT: That's all right. That's all right. Then you can have an opportunity to make an opening—

or a response opening statement before I proceed with the evidence.

MR. GEORGE: Before I call any witnesses certainly would be the case.

(At this time there was a brief discussion off the record.)

MR. GEORGE: Why don't we invoke the rule at this point in time?

MR. MENDEZ: Okay. Can I designate Wanda Hutcheson then as our agency representative?

THE COURT: All right. Any other witnesses?

MR. GEORGE: Is there any witnesses in the courtroom?

MR. MENDEZ: Yes, there are.

THE COURT: All of you please stand and be sworn.

(p. 9) (At this time all witnesses present were sworn.)

THE COURT: All right. The rule has been invoked; therefore, it's going to be necessary for all of the witnesses, other than the parties and designated representative, will be out of the courtroom at all times while testimony or other proceedings are being presented to the Court. You are further instructed not to discuss your testimony with any of the other witnesses in the cause but only with counsel.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 1 through 23 for identification, and a brief recess was taken, after which time the proceedings continued as follows:)

MR. GEORGE: Okay. We will offer into evidence Exhibits 1 through 23.

THE COURT: Any objection? If there's no objection, they will be admitted.

MR. GEORGE: These represent the letters of protest that have been filed by the taxpayer each month, with the exception of the first payment, which was on a (p. 10) quarterly basis. The taxpayer has paid the tax under protest, and the basis of protest is set out in there. With relevance to Mr. Mendez' plea to the jurisdiction, there are three different kinds of letters. There are the letter that was written by Mr. Gerhart, general manager, on the first one, which is a pretty general letter, a letter that I authored, which are exhibits—which is the February letter through October of '85, which are essentially the same. Then there is the September payment which was sent on October 18th, which was different in that it added the language that appears in paragraph eight to the second amended petition, which was filed within 90 days of the mailing of this letter on whenever it was—January something, and that petition tracked this letter. It is our position in response to the plea to jurisdiction so that the record will be a response. If we recover on the basis of the language in paragraph eight, we would be entitled to recover only for those letters that are with each month that contain the right language and not for the protest of others. We can—I think the statute contemplates each (p. 11) month's payment as a separate controversy, and we've filed them on that basis. I introduce those, and let me now turn to my opening statement.

As I say, this is a sales and use tax case, with the sales tax on magazine subscriptions being effective on October 2nd, 1984 and part of the legislation passed that summer session. We have come to the Court—well, first of all this is a sales tax that applies to magazine subscription sales on its face that is—there is no particular language addressing magazine subscriptions. They are simply nonexempt. It applies facially neutral to magazine subscription sales just like all other tangible property. So there is nothing in the statute that singles out magazines for particular treatment by language of the statute. We contend that nevertheless we are entitled to relief from the burden of paying the tax for constitutional reasons, and there are three basic reasons for that.

The first surrounds a case—the first two—a Minnesota—the Minnesota case, I'll call it. It's the *Minneapolis Star* (p. 12) *Tribune v. Minnesota Tax Commissioner*, a copy of which is in the notebook. That is a sales and use tax case by the Supreme Court of the United States in 1983. That case established—involved a use tax on the ink and paper used to print newspapers in Minnesota. There was a general use and sales tax in Minnesota that was essentially the same as Texas. The basic proposition of sales tax is the person who uses the underlying product pays the tax. When I go to Merritt, Schaefer & Brown and buy myself a new pair of socks, they give me the socks. I gave them the money plus the tax. I pay the tax. When I use something from out of state, I'm obligated to pay the tax. If I don't pay the tax to the vendor, I'm supposed to pay a use tax. It's the basic system in Minnesota that is in existence in Texas operating the same

way. The newspaper subscriptions and newspaper sales were exempt. Most other—

THE COURT: Is this—excuse me for a question and its lack of order—something out of a catalog?

MR. GEORGE: Yes, sir, that's a critical part of this case—is mail (p. 13) orders, exactly.

THE COURT: All right, and if I order something out of a catalog and it's shipped from Oklahoma and—but it's shipped to me as an ultimate consumer, I'm supposed to pay a Texas sales tax?

MR. GEORGE: That's right. The statute is—you're supposed to pay a use tax.

THE COURT: A use tax? But they call it a sales tax, of course?

MR. GEORGE: Well, the statute is a sales and use tax and it operates—and these statutes began during—right after the depression, and they're operated to avoid consumers buying everything by out of state vendor so the state will not lose all of its revenue. Therefore, there is an intergrated tax system in Texas, as there was in Minnesota, to levy a tax—it varies in Texas from place to place—on the use of—purchase and use of tangible personal property. Now, the Minnesota tax like Texas—generally exempt component parts. If you are manufacturing a radiator and you put all of the parts in, you don't pay use (p. 14) taxes generally on what you put together. The concept is the tax is paid when the man buys the radiator from you. Then the use tax—or the sales tax is paid, or if doesn't—if he's exempt for some reason, he pays a use

tax to the State. That is the concept. In Minnesota they singled out newspapers to tax the ink and paper, even though the ultimate subscriptions were exempt, and the Supreme Court said, "You can't do that." The reason—you treated them differently. Now, also that tax in operation—while facially neutral in the sense it applied to all newspapers, when you computed up the money, there were only two newspapers. One, the big one in Minneapolis, paid two thirds of all of the taxes collected under that provision. They said that discriminates against a particular member of the press; and therefore, it's unconstitutional for those two reasons. The important part of that case—and the case is critically important because it tracks the constitutional history of the First Amendment and the levying of tax on the press citing some of the Federalist papers and others, in which they said, "Taxes on the press have particular (p. 15) scrutiny," and they said—and this is a critical part of it—is the compelling interest test applies. The recognition was that for all other tax disputes the Legislature has very wide discretion. It can decide to tax combines and not tractors. It can decide to do—and if is has a rational reason, then it's not subject to dispute. They have varied widely to raise revenue. The important holding is that the First Amendment—

THE COURT: This is to quote the First Amendment? Then I understand.

MR. GEORGE: —First Amendment, because of the constitutional—the sensitivity of taxes on the press to any tax that operates—that is facially discriminatory or operates in a discriminatory manner—that discriminates against the press is one that must be justified by com-

pelling interest. There must be a compelling reason that you do it this way.

THE COURT: And not just to raise revenue?

MR. GEORGE: And not just to raise revenue, and so that's the critical part, and we believe the facts. We have—will (p. 16)—prove two kinds of discrimination. The first kind of discrimination is what we call a discrimination against Texas magazines. We believe that the evidence will show that the tax is paid by Texas magazines, but all of the other magazines that you read, such as *Reader's Digest* and *American Sportsman* and all of those other magazines—no tax is paid or collected; and therefore, only people who happen to have their home offices in Texas pay the tax, and we will show there's plenty of constitutional power to tax the other people, if they chose to. Second—and this is paragraph eight issue that we need to—that Mr. Mendoz has objected to—is what we call the gross receipts effect. We will show that for magazines sold by mail order by subscriptions there is no effective way to collect the tax; that is, if you go into Merritt, Schaefer & Brown and buy a pair socks, they can say, "Pay the tax or don't get the socks. If you order—because of the peculiarities of dealing through the mail and the economics of the magazine industry, if you order magazines and you don't deliver them because of failure to pay the tax, you go out of (p. 17) business. It operates and is paid by the Texas magazine industry and by my client as a gross receipts tax because they have found it impossible to collect on—

THE COURT: Can't they have it included in their subscription price?

MR. GEORGE: Well, you can raise your price is the theory—raise your price, and if you raise your price, you decrease your subscribers, but more importantly you are, one, paying essentially gross receipts tax. If you simply raised your price and paid 6.12 percent of everything you take the State of Texas, that's very different than I can have—Merritt, Schaefer & Brown can have a sale and still charge me the tax and make me pay it, and it doesn't matter to them whether the tax is there or not. Texas Monthly can't do that because they've got to take it off the top and send it in because they can't get you to pay it to them, and the evidence will show that. That's called the gross receipts effect and that—this is discrimination—

THE COURT: Really the question is the mechanics, and you'll get into (p. 18) that, won't you?

MR. GEORGE: I'll show that. The next constitutional concept is one which will also require substantial evidence, and that is one under Article 8, Section 1 of the Constitution of Texas. Now, this is a provision that's been in the Texas Constitution since the first constitution since we were a state in 1845, and it says, "All taxes shall be fair and equal," and it's been elaborated on to some extent, and it has been applied at least back to 1895 in cases in which a taxpayer can come in and show a plan or scheme to leave property off the tax roll and I—all of the cases under that statute that I have found are ad valorem cases, and I want to give that to the Court up front, but the statute—the constitutional division applies to all tax collectors. We will show that the Comptroller has a plan, scheme, intentionally does not collect tax from either the vendors of out of state magazines, the people who sell them, *Reader's*

*Digest*, although they have authority to do it and know it, made a political decision that it would be unwise to, and, two, they have (p. 19) made a political decision that although the statute requires consumers to pay the tax to not do anything to collect it from the consumers, and so if a citizen chooses to read *Texas Monthly*, they pay a tax, or tax is part of the gross receipts that they turn in. It is paid for them, but if they choose to read *Reader's Digest*, that doesn't happen, and the Comptroller knows that, knows that the Legislature, in its wisdom, made the *Reader's Digest* user just as liable for the tax as the *Texas Monthly* user, but they decided it's not a wise tax. It's not easy to collect so they're going—and it's politically devastating to an elected officer to go out and try to collect the tax from people who owe it. So they don't try.

THE COURT: It's paid then on the—

MR. GEOGE: Well, I don't know that they have any evidence that anybody ever paid it, but the cases that you will find under this statute are cases in which the Duval County School District decided that they could raise enough revenue from the oil companies, and so they went around got all of the oil companies (p. 20) to pay the ad valorem taxes and just winked at the farmers and ranchers in the county and they just didn't pay their taxes, and they never did anything about it, and they had a system to —in the old days when we taxed land and intangibles, they simply made no effort to tax these stocks and bonds and main deposits and all of those things. They just winked at that obligation because it's hard to collect, and they collected all of the money from the real estate developers. There's dozens of cases in Texas in which if a plaintiff

can prove that they do that and they're harmed—and my client will show—

THE COURT: Or they systematically do it, I assume?

MR. GEORGE: Yes, systematically do it. They do it—they consciously do it. They do it because they have—they just decide it's wise to do that, for whatever reason, beyond their power. In other words, the Legislature or somebody set up a system to tax that way, and they just don't think that's particularly a good idea. So they won't do it. That's unlawful. You have to show (p. 21) harm, and we intend to do that, and finally what I call the pure First Amendment issue in a part of our case, and that's the religious periodical exemption.

THE COURT: How do you determine what is religious and what isn't?

MR. GEORGE: Well, Ms. Hutcheson or Mr. Rogers either has a system of anything that is published by what they consider religious faith is exempt, or they read it and decide, all right?

THE COURT: What if *Texas Monthly* has an article in there by some Episcopal priest or someone else?

MR. GEORGE: We have had over the years a traditional religion review column. We had a guy named Bill Martin for years and years and years that wrote a column about—reviewed preachers. He would go to famous preachers around the state and write articles. He hasn't done that in a year or so, but that's a traditional thing. Our argument is that—and we'll show that there is a constitutional basis for exempting activities of churches along

with all other eleemosynary (p. 22) institutions; that is, you can exempt the Boy Scouts and the Baptist Church and the American Cancer Society and all of those other institutions, and the Constitution lists it that way, as does the statute for all other sales tax lists them that way, but there is a provision that if it's a religious periodical it doesn't pay any tax. Our argument is classic First Amendment, that is, the granting, withholding of government benefit based purely on what people say—not what they do. Now, that's a very important distinction because what churches do along with other eleemosynary institutions can be encouraged by the State, and I don't want the Court to think I'm arguing that this is unlawful to have things benefit churches. This one doesn't say anything about what they do. It says that if a—if there is a periodical published by a religious faith that consists of the teachings of that faith, it's exempt—nothing about activity, nothing about good works only about what is said in the periodical. We will present—

THE COURT: Isn't that a very fine line between activity and—

(p. 23) MR. GEORGE: Well, Your Honor, the classic case is the man carrying on the picket line. When he's walking around with the words on his sign, he's speaking. When he starts swinging the picket sign, he's acting, and that's a distinction that First Amendment cases require all of the time—is you can stop activity. You can—the government can reward or punish conduct. When conduct is speech, however, you can't do it, and that's in First Amendment cases, one of the classic distinctions that have to be drawn—is between the man who's making the speech

and the person who's doing things, and that's not an uncommon thing. The classic—we think the classic content based discrimination case is one in there which is—content discrimination is a case that is a picket case, which is a—we have a city—the Chicago Police Department versus a man named Mosely, and Mr. Mosely had a dispute with the school because they thought that they favored black students over white students, and he walked around outside with a picket sign that said Taylor High School discriminates in favor of blacks—peacefully, no disruption. He just (p. 24) walked around outside of the school. The City of Chicago passed an ordinance saying you can't picket schools, except if it's a bona fide language dispute. The Supreme Court said, "Mr. Mosely is entitled to picket." If you're going to give somebody an exemption from your ordinance based on what the sign says, you violate the First Amendment. They made it clear that if they're doing something bad—if they're beating up people or they're too close to school—I mean, you have a 25-yard set back rule or something else—all that is fine but only the ordinance—

THE COURT: But not content of the—

MR. GEORGE: —What the sign says. Here it's what the magazine says.

The COURT: I guess—do they ever get into the question about pornography on a sign? I know that puts it in a little bit different light.

MR. GEORGE: You know, in a case in which there is—I haven't dealt with—because there is the concept of unlawful speech, and there are three kinds of classic unlawful (p. 25) speech not involved in this case, but there

is pornography, which is obscenity, which is the legal term, which is unlawful speech. There is inciting to riot, which is the fire and—and that's unlawful speech and can be controlled, and then there is the treasonal State secrets—publishing secret military basis. Those are the classic kinds. The content of speech is subject to it. Nobody contends that even religious teachings or what *Texas Monthly*—is illegal. So we just have a classic content. There is one other case in that notebook you need to look at when you have the opportunity, which is *Speiser v. Randall*, which is a tax exemption First Amendment case, and during the 1950s California had a veterans' tax benefit where veterans had exemptions from certain ad valorem taxes, but they had a rule that if a veteran advocated the support of a foreign government they couldn't get the tax exemption. Justice Brennan or I think the Court said, "You can't have a tax exemption that turns on what people say," and we believe this exemption is that. Now, that's the outline of our case, and that's my opening statement.

(p. 26) THE COURT: Mr. Mendez?

MR. MENDEZ: Thank you, Your Honor. Well, if I may approach this—

THE COURT: Sure.

MR. MENDEZ: —I think it will help to visualize what our case is.

THE COURT: Do you want to flip the page or—

MR. MENDEZ: No. I think we can work with this. The first thing—let's go through this, and then I'll get to some of the other points that I want to raise, but Mr. George says that the Minneapolis Tribune case requires that the State show a compelling State interest for taxing

magazines. We haven't taxed anybody because what happened up here—we had a sales and use tax in place on all tangible personal property. We've, of course, taxed magazines—applied use taxes and sales taxes to them for years, as they're sold over the counter, and in fact, from the time that they were first created in 1963 even subscription sales—1961—even subscription sales were covered by the sales and use tax. About 1977 the Legislature, for whatever reason—I mean (p. 27) there's no clear indication of their intent—exempted subscription sales that were longer than six months in that from the tax.

THE COURT: That there were what?

MR. MENDEZ: If you sold a subscription to someone for a magazine, a periodical, and it was for a period longer than six months, it was exempt from sales or use tax. That was a provision. Well, we ran into a money crunch obviously in 1984. They were trying to fund the school systems and the new school fund, and they had to find money, and the legislators went in and started knocking out exemptions, which is a very good way of doing it, and they knocked out the exemption for religious—I mean, for subscription sales of magazines. So now they're back under the law—no tax on magazines. There have always been tax. There's no tax created on magazines. Minneapolis Tribune case—let's exempt everybody below a certain number of sales from the use tax, and let's stick it to these guys up here—these newspapers that are real big that happen to haxe been giving the Minnesota Legislature a hard (p. 28) time, by the way, and so that's the basis of that—of that Minneapolis Tribune case. We've got a case subsequent to that—a North Carolina case. The Village Publishing Company was assessed some sales and use

taxes. Well, let me give that one to the judge. I've got another copy. In North Carolina they assessed a tax on a newspaper over there, and they raised Minneapolis Tribune. You can't tax us because you're creating a special tax on us. What had happened is they had become subject to the general sales and use tax act. The Court said Minneapolis Tribune doesn't apply. They went to the Supreme Court. It was dismissed over there. Interesting argument, though, and probably we should deal with it, but we should deal with it on the basis that the Constitution works. You cannot discriminate between Texas magazines and out of state magazines, if they're in the same class similarly situated. That's a basic test. I mean, if you're going to complain—

THE COURT: What do you mean by situated?

MR. MENDEZ: Same person, same types of situations, the same type of (p. 29) person.

THE COURT: Not location?

MR. MENDEZ: Not location. It's not a geographical test. Another person—and that's a legitimate complaint. Another person just like me is being treated differently. I think that in order for them to prove that they've been harmed in this state they're going to introduce evidence that other magazines that are located in the State of Texas, have their headquarters here, and they sell to people maybe in Dallas or Houston—they're going to show that those people have also experienced the same types of problems. Exerybody is being affected by the tax the same way. They're going to try to show that there are some people outside the State of Texas that have such little contacts—those catalog sellers that you might

be purchasing from have such little contacts with the State of Texas that we are not doing anything to them. Well, there's a good reason. There's a Supreme Court case that says we can't do it—Bellas Hess.

THE COURT: What about Bullock's press statement here recently where (p. 30) the State is losing a lot of sales tax on our—

MR. MENDEZ: Exactly, but the reason we can't get them is because we can't force those people to collect a tax for us, and certainly it's obvious—and the cases have dealt with it, and we've cited them. If you'll kind of—kind of—we'll be citing cases about obvious and things that are general knowledge, but it is impossible for anybody to carry on a sensible system of taxation where every household in the state, in fact, every individual in the state has to hold a tax use permit just so that they can report the 3 or 4 or $5 or whatever that we may owe in taxes, as a result of out of state purchases that we use and consume and store in the state. That's a distinction.

Supreme Court case says we can't make those people collect it for us. Common sense and our carrying out our Legislative intent of revenue raising says that we're not going to spend 17 or 18 or $20 to go collect 5. That's this right here. Now, the Canteen case—*Canteen v. Calvert* in 1963 is a case where a vending machine person brought in (p. 31) the same problem that Mr.—that *Texas Monthly* is bring in here. They said, "We collect"—"We have these machines out there. People deposit money in them. How are we supposed to collect a use tax from those people? How are we supposed to collect a sales tax from selling products here in the State of Texas?" The Court said, "That's not an argument for not collecting tax. It's a

transaction. You've got your transaction. That's what gave rise to it, and if you can't show who"—"if you can't show or go out and collect it from someone else, you're still liable for the tax under constitutional law both in Texas"—and I think it also applied to federal constitutional law.

We go over here to Article 8, Section 1 of the Texas Constitution. This is a real heavy burden right here, harm, and I'll get into that in a minute, but I think that we have to talk first about uniformity and equality, as applied to these general classes. We cited the Hurt case—*Hurt v. Cooper* because that's the big case in that area, and I didn't give you a copy of it, Your Honor, but it permeates our brief but—and that was a general type tax, (p. 32) and it said—and it equates standards under the Texas equality statutes to, in fact, Article 8, Section 2 to the federal constitutional law and equal protection and due process, and so we cited it, but then lately we were looking at it. Well, why are there only property tax cases cited in Article 8, Section 1, and why are all of those cases always dealing with the statutory system by which assessments occur on the tax rolls of the particular county? Well, the reason is because there's some real old cases—two old cases—one from Edinburg and one—let me borrow this. We have the case of *Ana-Log, Inc. v. The City of Tyler* and *Edinburg Improvement Association v. The City of Edinburg*, and these cases say that you can't if the city official—if the county official that's assessing the tax applies the tax in an unequal manner, then Article 8, Section 1 does not apply. So on an as applied basis—and that's the only way you can get to a case in this court today—is that Mr. Bulloek or the Comptroller's office is

not applying the tax on an even basis by administration. Then it does—this statute doesn't apply. So it would have to be a plan (p. 33) set out in the statutes. The Legislalature picked on *Texas Monthly* and those people and didn't pick on others that were similarly situated? That's not the case we have here today because again similarly situated means those magazines that have nexus with the State of Texas, that have contacts sufficient to make the Comptroller—to allow the Comptroller to make them collect the tax for us. There's a bunch of people—and you'll here (sic) a lot of evidence on the millions and millions of dollars that are coming into this state in terms of—or that we're losing out on and that you've seen in the papers and maybe on TV, but there's no way for us to collect it.

Now, there's a—getting into a little but about the Supreme Court law on that, we have to call it a use tax because the United States Supreme Court said we had to. Sales tax cannot be assessed by the State for a transaction that's consummated in another state. So the vehicle is, okay, we can't tax that, but if you bring it in here and we use it, you've got sufficient nexus, and we'll pick it up from you, the consumer, or whoever—if the person (p. 34) that is selling it to you has sufficient contacts, we'll make him do it, and that's the reason for that constitutional gimmick of having these two complimenting taxes. We've covered that in our brief and the statutory scheme to give you an idea of how that works.

Now, this argument on religious publications. To answer your question as to why *Texas Monthly* wouldn't qualify, first of all, because it's not a religious—

THE COURT: Well, that's not the problem with me. My basic problem is the argument—I don't think they're

going to try to get qualified as a religious publication. Their problem basically is that by singling out you're using an invalid test for an exemption.

MR. MENDEZ: The test as—

THE COURT: Because content doesn't make—and that's a subjective test for someone else making it who may and may not and that invading the First Amendment.

MR. MENDEZ: Two things on that, Your Honor. First of all the evidence will show that the Comptroller doesn't want to get into deciding what's religious and what's (p. 35) not, in terms of content of a publication. So what they do, right or wrong—that may be something for you to decide—is that if it's a religious organization, if it meets all of the criteria set out by the Legislature under the Sales and Use Tax Act, anything that it publishes that is a periodical is going to be—a periodical that is sold on a regular basis is going to be exempted under that statute. The second thing is why do we have to get into that? The only thing that *Texas Monthly* can stand to gain from this is a voiding out of that exemption. Your Honor cannot bootstrap *Texas Monthly* into the religious periodicals exemption. It cannot expand an exemption. That's the way the constitutional law—

THE COURT: I don't think they're asking me to the way I read the statement so far; is that right? You're not asking to be bootstrapped into—

MR. GEORGE: Our position is such as *Speiser v. Randall* and the Chicago case. If there is an unlawful exemption in the statute, then you're entitled to be treated

equally to those people, which means not taxed (p. 36) until the Legislature chooses to abolish that exemption. That's the rule, and just like those veterans and just as Brennan's case and Speiser's case, their remedy was to get the tax exemption. They went in there and said, "You're not letting me have a tax exemption because I have advocated this position, and you're enjoined"—asked for an injunction from the State of California and enjoined them from not letting them have their exemption because somebody else got the exemption, and that's unequal protection. As long as that's on the books they cure it by repealing the statute.

MR. MENDEZ: Your Honor, we have to repeal the statute.

THE COURT: I don't have to. That's up to the Legislature.

MR. MENDEZ: Well, Your Honor, if that's—it's an exemption. The exemption is these people get treated special.

THE COURT: All right, but I don't—

MR. MENDEZ: And everybody else gets treated over here. I'd have to brief those cases. I'm not—

(p. 37) THE COURT: I know but I'm—well, it's clear enough to me as to the issue. I'm not—I will grant you that—

MR. MENDEZ: Well, Your Honor, our argument is these are the people that are being treated special. Everybody else is being treated in a uniform manner including *Texas Monthly,* and if these people are being treated spe-

cial and the reason they're being treated special is because—

THE COURT: Because of content.

MR. MENDEZ: —on content, then those people—because it's an exemption, they should be treated like everybody else, because if you work it the other way, then everybody that publishes anything, tha' writes letters maybe—I don't know—would have to be allowed to be exempted, and so you're enlarging the capacity of the exemption. So what you'd have to do is knock that out and say "Until you can show me that there's a valid reason for that, then you've got to do that.

THE COURT: All right.

MR. MENDEZ: So that's why (p. 38) we feel that that's at odds because there's nothing to gain from doing something like that. We're going to show that the State has valid reasons for doing that—avoiding entanglement, various other reasons, most of them which have been addressed in many U.S. Supreme Court cases and—

THE COURT: Okay.

MR. MENDEZ: Now, before we begin the evidence on this case, I want to remind Your Honor that when you've got a constitutional law case like this there are a lot of presumptions that run with the State and we felt real comfortable about this case all the way through, but we wouldn't file a motion for summary judgment because we didn't want to lose out on any of these presumptions, which are, as far as we're concerned, relatively insurmountable, at least under the facts today, to overcome. There's a presumption of constitutional act by the Comp-

troller's office and we've briefed that point out for Your Honor in detail. The acts of a state official are always presumed to be constitutional unless there's clear plainly—

(p. 39) THE COURT: That's a presumption of everything, isn't it, Counsel—presumption of constitutionality of everything pretty much in first flush?

MR. MENDEZ: Well, what you—you must uphold it, if there's any reasonable reason for upholding it. Any doubts that must be resolved—if you've got a doubt in your mind, you've got to resolve it in the Comptroller's favor, as far as how he administers the tax.

Now, from an evidence standpoint, if we're going to follow these Article 8, Section 1 cases, not only does he have to show you that he's been treated differently from others in his own class, not only does he have to show you that the Comptroller has some malicious intent or some other type of intent that borders. I guess, on the fraudulent, to do that, he's got to show you how many dollars he's going to be out-of-pocket that—different from the others in his class, and now, what we're going to go through in our defense basically is show you what the Comptroller's office does point by point, and (p. 40) it's going to be a long—an arduous journey, but I think we can make it interesting, and we'll show that the Comptroller does the best he can in administering these statutes, and in fact, it does—it goes well beyond the necessary limits of this constitutional argument.

We're going to show that there's no intentional plan of discrimination, and there's no intentional plan by the mere operation of the statutes, and then we're going to

show you in detail on what you've been reading in the paper or maybe seeing on TV—is what has the Comptroller been doing in Washington and throughout the country with the MTC and others to get those people that are similarly situated to Texas Monthly that might have nexus but where the law is real gray, and we've got people out there that are doing that job, and we're going to show the Court how that's being done, and in the end we're going to show that Texas Monthly doesn't meet any of those constitutional tests that it's set out here and that it can't show any harm to itself and with that in mind, Your Honor, we rest.

THE COURT: Thank you.

(p. 41) MR. GEORGE: One legal point because the Court is going to have to read the briefs, and we'll probably have a briefing schedule, but on the nexus similarly situated issue, I want the Court to look at a case called *Scripto v. Carson*, which is in my brief, which when the Court gets a minute, it's a case on the question of who can the State compel to collect the tax is the question of who has enough contacts with the State to do it, and the Scripto case involves agents who go into the state to take orders, and the Supreme Court said, "If you send people in or you have people"—"whether they're your employees or others"—"go into the state and take orders to sell your product in that state"—that's what they use in this—is nexus. That's plenty of contact with the State to do it, and we'll show that all of the national publications that are in—which we believe similarly situated have that. So—

THE COURT: Have people coming in?

MR. GEORGE: Yes, sir, or have agents here who take their orders and take orders for them and send them off and have them (p. 42) filled and people who are here in Texas. With that, we'll call our first—

THE COURT: Is that one of these people that knock on doors and come around with all of these magazine subscriptions wanting you to sign up for?

MR. GEORGE: Yes, sir.

THE COURT: Okay.

MR. GEORGE: Those are our order takers.

THE COURT: I understand.

MR. GEORGE: And those are order takers for all of the national magazines, and I will call Wanda Hutcheson.

THE COURT: Weren't you sworn?

THE WITNESS: Yes, sir.

WANDA HUTCHESON

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, would you state your (p. 43) full name and address for the record, please ma'am?

A. Wanda Hutcheson. I live at Route 1, Box 123-K in Lockhart, Texas.

Q. How are you employed?

A. I'm a—I work for the State Comptroller.

Q. How long have you been with the State Comptroller?

A. It will be 20 years in April.

Q. Is it true that your job is to tell the people who call into the Comptroller and who are seeking information from the Comptroller the Comptroller's policies on tax issues?

A. Yes, sir, that's correct.

Q. What's your position called?

A. Currently I'm administrative assistant to the Deputy Comptroller.

Q. And who's the Deputy Comptroller you're the administrative assistant to?

A. Mr. George Garland.

Q. And how—you were—gave a deposition back in the summer of '85 in this case. What was your position then?

A. Supervisor for sales tax policy.

(p. 44) Q. And was your duties then at that point in time to know the sales tax policy of the State of Texas and to communicate that to the public?

A. One of the duties, yes, sir.

Q. Are those still your duties?

A. Yes, sir.

Q. And how long have you been in the position of being aware of the sales tax policy of the State in communicating those to the public?

A. 15 or 16 years to some extent—one extent to—my responsibilities have increased, but I have been in policy for about 15 or 16 years.

Q. Now can you tell the Court how the sales and use tax works?

A. Sales tax is a tax that is collected from customers on sales made in Texas from Texas sellers. The use tax is a tax on merchandise coming into Texas from out of state.

Q. Now, is it the system of taxation that the—all transactions and uses of tangible personal property subject to the tax are supposed to be taxed under the statute?

(p. 45) A. Unless some exemption applies, all sales in Texas of tangible personal property are presumed subject to either the sales or use tax, yes, sir.

Q. And so that a use of a product purchased in another state is subject to the tax?

A. Yes, sir.

Q. And that's what the Legislature said?

A. Yes, sir.

Q. Okay. Now does it operate so that if my wife goes off to Bloomingdales in New York and have them mail her some china and we use it in our house that I'm obligated—or I guess she's obligated, I hope, to pay the use tax on that?

A. That transaction or that use would be subject to use tax, yes, sir.

Q. And when I order a copy of Runner's magazine from New York City and they send it to me and I pay the subscription, am I obligated to pay a use tax on that subscription?

A. Yes, sir.

Q. Now, I believe you told the Court during your deposition that you subscribed to Reader's Digest?

(p. 46) A. Yes, sir, I did at that time.

Q. And have you dropped your subscription?

A. It has lapsed, yes, sir.

Q. I'm sorry to hear that. Did you pay your sales—your use tax on your subscription to Reader's Digest when you subscribed?

A. No, sir, I did not.

Q. Have you ever paid a use tax on products that—or magazines that you've gotten through the mail?

A. Only those with—where the subscribers were in Texas and collected it or added it to the bill. If they added it to the bill, I paid it, yes, sir.

Q. But if someone sent you a magazine from out of state and there was no tax, they weren't—it's your understanding that if they live outside of the state they're not supposed to collect the tax—no obligation to collect the tax? Is that the policy of the Comptroller?

A. If they had no representation in Texas, that's correct, sir.

Q. And that's your policy?

A. Yes, sir.

(p. 47) Q. Okay, but do you have a form that citizens can file their use taxes with?

A. There is a form that is available, yes, sir.

Q. Do you distribute it? Have you ever sent one to a regular consumer like my wife who bought something from Bloomingdales to pay a use tax with?

A. Only if they request it.

Q. But, in fact, the matter is there has never been an effort by the Comptroller to go out and force any consumer to pay a use tax, has there, in the 20 years you've been there?

A. That's correct.

Q. And there has never been an organized system designed to encourage or foster or promote voluntary compliance, has there?

A. Not to individuals, no, sir.

Q. And in fact, you have sent out all of your mailings about compliance with this system to pay your use tax to businesses—not to consumers, haven't you?

A. Yes, sir. Those are the ones that we have on file, and those are the people that we know about, yes, sir.

(p. 48) Q. The Legislature didn't make that decision. You know that citizens and consumers are obligated to pay use tax just as my law firm as a business is obligated to pay use tax aren't they?

A. Yes, sir, that's correct.

Q. And in the 20 years that you've been with the Comptroller's office the use tax has been on the books, hasn't it?

A. Yes, sir.

Q. And during those 20 years, you or your supervisors have made the decision not to do anything to enforce that obligation against consumers, haven't you?

A. We have not made any effort to collect it from individuals as a general policy, yes, sir, that's correct.

Q. Now, you sat on a committee, did you not, that deals with the implementation of the new changes—the changes in the tax law that became effective October 2nd, 1984, did you not?

A. Yes, sir.

Q. And in fact, one of the things that were done involved the implementation of a bunch of items or taxes on a bunch of items that had (p. 49) not been subject to tax before—dry cleaning, for example?

A. Yes, sir, that's correct.

Q. Massage parlors?

A. Yes, sir.

Q. Turkish baths?

A. Yes, sir.

Q. A whole bunch of things that had never been subject to tax before; isn't that right?

A. That's correct.

Q. And in fact, the Comptroller's office sent out special people to call on all of those people to tell them that they're obligated to pay a tax, didn't they?

A. Yes, sir.

Q. And in fact, the Comptroller sent not one sole to any out of state magazine publishers to see what they were doing in Texas to make any investigation at all, did they?

A. Not to my knowledge, no, sir.

Q. You sent somebody to all of the newspaper publishers, didn't you?

A. There may have been someone in the department. I didn't send—the policy did not (p. 50) send anybody, but I think the Comptroller's department did, yes, sir.

Q. Your committee consisted of people from legal division, enforcement division and administration?

A. Yes, sir.

Q. And you were a member of the committee?

A. Yes, sir.

Q. And the committee's job was to implement the new sales tax—use tax?

A. Well, technically the committee's job was to set policy on the new taxes—not necessarily to make contact with those people, other than if they came in and asked us.

Q. Yes, ma'am, but part of that policy was to try to—to set the policy of how you were going about to implement it?

A. Yes, sir.

Q. That was part of the policy determinations of this committee?

A. Yes, sir.

Q. And the policy determination on implementation of the tax involved, for dry cleaners, extensive contact to encourage (p. 51) voluntary compliance and enforcement, didn't it?

A. After the Association for the Dry Cleaners had asked for a meeting with the policy committee, we did meet with them and give them some guidance, yes, sir.

Q. And you knew them—you set up the system or knew about a system to call on dry cleaners by the Comptroller's personnel?

A. That wasn't a policy decision, sir. That was from field operations.

Q. Yes, ma'am, I understand, but that was something that you became aware of, as part of that committee operation, as part of the policy of implementation of the tax, wasn't it?

A. Yes, sir, that's correct.

Q. And you understood the same system of implementation of the tax, as regards newspaper subscriptions. You went out and had people call on newspaper publishers and news boys and people that distribute them house to house, didn't you?

A. Yes, sir, after the Newspaper Association had been in touch with us.

Q. Yes, ma'am, and you did that for almost every other industry, didn't you, that (p. 52) came under the tax?

A. Field operations did, yes, sir.

Q. But you did nothing for magazines to encourage voluntary compliance for the people who are obligated to pay the tax?

A. To my knowledge, that's correct.

Q. Not a thing?

A. That's correct.

Q. And that was a part of the decisions of that policy committee that you sat on?

A. It may have been a policy decision by omission. I do not recall magazines being discussed by the policy committee at all.

Q. Okay. Now, in connection with the sale of magazines, you are aware that magazine people come to people's homes in this state soliciting orders for magazines, are you not?

A. Yes, sir.

Q. In fact, people have come to your home?

A. That is correct.

Q. And had a whole list of magazines?

A. Yes, sir.

Q. And the list included a lot more magazines than were published in Texas?

(p. 53) A. I would assume so; although, I don't remember reading the list, but they did have a list.

Q. And it was a long list—

A. Yes, sir.

Q. —of commonly national publications?

A. I would assume so, yes, sir.

Q. And you've known that was a practice in Texas as long as you've been with the Comptroller, haven't you?

A. That's correct.

Q. And you knew it when you sat on that policy committee?

A. Yes, sir.

Q. And you—and did you do anything to try to see that the magazines that were distributed nationally that had people in Texas going from house to house taking orders for those magazines, in fact, collected taxes from Texas subscribers?

A. No, sir.

Q. Now, you had a meeting with Mr. Gerhart, did you not?

A. Yes, sir.

Q. A couple of meetings?

(p. 54) A. Yes, sir.

Q. And about the time the tax was being implemented?

A. I think around that time, yes, sir.

Q. Okay, and Mr. Gerhart came to you with a list of organizations that he thought were selling magazines in Texas and that didn't—he didn't think paid taxes and offered you the names and addresses and opportunity to contact them and see if you could collect a tax from them, didn't he?

A. He did give us such a list, yes, sir.

Q. Okay, and that was in October or November of 1984, was it not?

A. Yes, sir.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 24 and 25 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what's been marked Plaintiff's Exhibits 24 and 25 and ask you if you can identify those, please, ma'am?

A. Yes, sir.

Q. What are they?

A. These are the two types of letters (p. 55) that we mailed out as a result of the list that Mr. Gerhart submitted to us.

Q. Now, you mailed that list out seven months after he brought it to—those letters out seven months after he brought you the list, did you not?

A. Yes, sir, that's about right.

Q. And you did that only after he had given a deposition, and you were about five days from your deposition in this case?

A. Yes, sir, that's correct.

MR. GEORGE: I'll offer Exhibits 24 and 25.

MR. MENDEZ: No objection.

QUESTIONS BY MR. GEORGE:

Q. Now, you had conversations with Mr. Gerhart and other members of this policy group or other people employed by the Comptroller's office in the fall of '84 about the practices of the industry, did you not?

A. Yes, sir.

Q. And you had conversations in which he reminded you of the door to door solicitations of magazine sales agents—solicitation agents?

(p. 56) A. Yes, sir, I think that was mainly the first meeting, but it could have been part of the second one also.

Q. All right, and in connection with that—those conversations, Mr. Gerhart told you that it was a common practice for magazines in this state—or magazines sold to residents of this state to have arrangements with school children and people going to school to go door to door to solicit orders for magazines?

A. Yes, sir.

Q. And gave you some names of the companies?

A. Yes, sir.

Q. That solicited the orders in Texas for magazines to be sold out of state?

A. Yes, sir.

Q. And you knew those names, and you did absolutely nothing to contact those people and see if Mr. Gerhart was right—whether they did solicit orders in Texas for the sale of magazines from out of state publications, didn't you?

A. I did nothing, that's correct.

Q. Did anybody at the Comptroller's (p. 57) office do anything?

A. Not to my knowledge, no, sir.

Q. You obviously knew you were doing nothing and did it anyway? I mean, you intentionally did nothing. It wasn't—nobody stopped you from doing it?

A. That's correct.

Q. You could have, if you chose in the course of your business, to pick up the phone and call Quality School Plans or TV Guide Plans or any of the other names—American School Plans or any of the others that Mr. Gerhart gave you names and ask them if they were taking orders for magazines out of state and verify the facts but you chose not to?

A. I called no one, that's correct.

Q. Nobody else did?

A. To my knowledge.

MR. MENDEZ: Your Honor, we've had some people enter the courtroom in the interim, and I'm not sure if they're witnesses or not.

THE COURT: All right. Any witnesses?

MR. MENDEZ: Thank you.

(p. 58) (At this time instruments were marked as Plaintiff's Exhibits Nos. 26 and 27 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what's been marked Plaintiff's Exhibit 26 and see if you can identify that, please?

A. Yes, sir, I recognize this.

Q. What is that?

A. That's an interoffice memorandum that I wrote after our meeting with Texas Monthly—our second meeting with Texas Monthly. It was addressed to Mr. Glen Castlebury.

Q. What was Mr. Castlebury's job at that time?

A. Associate Deputy Comptroller.

Q. In the hierarchy of the Comptroller's office, was he above you or below you?

A. Much above.

Q. Was he one of the senior people in the Comptroller's office?

A. Yes, sir, that's correct.

Q. One of the top two or three people?

A. Yes, sir.

(p. 59) Q. And during the meetings with Mr. Gerhart, had he given you some information about what he

thought revenue could be gotten from out of state publications that have people who take orders in Texas? We have some numbers in here.

A. I think there were some dollar figures given with the list of publishers, yes, sir.

Q. He had given you some calculations and said, "You can raise this money, and if you go out"—They have people taking orders in Texas, and if you go out and contact them, you can collect these taxes, didn't he?

A. Well, I think these were figures that he gave us that he thought amounted to Texas sales, yes, sir.

Q. Yes, of these companies?

A. Yes, sir.

Q. And then he told you about these companies, and you wrote the memo to Mr. Castlebury discussing what to do about it?

A. This memo was supposed to be the results of our meeting because Mr. Castlebury was not able to attend.

Q. And one of the references was the (p. 60) school fund raising projects where students sell magazine subscriptions?

A. Yes, sir, that's correct.

Q. And in connection with that you said, as a part of Exhibit 24—

MR. MENDEZ: 26.

QUESTIONS BY MR. GEORGE:

Q. —26, that you could try to call those people representatives, but you didn't think he wanted to?

A. Yes, sir, I made that statement.

Q. Okay, and it was because to do that—to treat these people as representatives of the magazines or the company would be politically unpopular; isn't that right?

A. I would not presume to think in Mr. Castlebury's shoes. I just got the distinct impression that he did not want to. Why he did not want to, I do not know.

Q. You remember testifying during your deposition about your belief that that was because of the political consequences of—

A. Yes, sir, I remember saying I did think it was my belief that that was the case, yes, sir.

(p. 61) Q. That it was because of his belief that it was politically unpalatable to treat these people and collect sales taxes—

A. Yes, sir, that was the feeling that I got from him, yes, sir.

MR. GEORGE: I'll offer Exhibit 26.

MR. MENDEZ: No objection.

THE COURT: All right. We'll take a 20-minute recess at this time.

(At this time a brief recess was taken, during which time an instrument was marked as Plaintiff's Exhibit No. 28 for identification, after which time the proceedings continued as follows:)

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, have you ever been present during a conversation in which there was discussion about efforts to collect the use tax owed by Texas residents who use property purchased out of state that is subject to use tax?

A. Individuals or businesses?

Q. Well, individuals, yes, ma'am.

A. No, sir, I don't think so.

(p. 62) Q. Never been—in the 20 years you've been there, that's never been considered in any way how one could do that—at least encourage voluntary compliance?

A. Other than the publications that we put out to our permitted taxpayers, I know of no other way that we've tried to contact individuals.

Q. Now, it is the Comptroller's obligation to collect the taxes that are due the State that are enacted by the Legislature; isn't that right?

A. Yes, sir.

Q. And the Comptroller is obligated to collect the tax, whether he thinks it's a wise tax or not, isn't he?

A. Yes, sir.

Q. And it's obligated to collect all of the taxes that are levied by the Legislature?

A. Yes, sir.

Q. And it's, in fact, true, is it not, that for the 20 years you've been there the Comptroller has never tried to collect the taxes owed by consumers for use taxes on

products, including magazines purchased from out of state (p. 63) sellers, when the—at all?

A. Not in any way on a consistent basis or ongoing basis, no, sir.

Q. Have they done it on a spasmodic basis?

A. We may have collected from individuals again but only as they hold permits.

Q. And only businesses have got permits?

A. Individuals operating businesses yes, sir, as well as corporate businesses.

Q. But you've got to be in business to get a permit?

A. Yes, sir.

Q. And then the Comptroller, despite the Legislature mandating that these taxes be collected, has set up a system where they aren't collected?

A. From individuals, that's correct, yes, sir.

Q. And it's intentionally set up that system?

A. Well, we've set up the system to collect tax from permitted taxpayers. I don't know that it was intentional, but it's worked out that way.

(p. 64) Q. Well, you didn't—in 20 years nobody did anything to even try to set up a system to collect taxes for magazines or any other product but magazines for this lawsuit that are used by consumers in Texas?

A. That is correct.

Q. And you've been in the sales tax policy for 15 years?

A. Yes, sir.

Q. And you've never been privy to any discussion about even considering ways to do that?

A. That's correct.

Q. Would you have been privy to such conversations?

A. Yes, sir.

Q. If there had been any?

A. Yes, sir.

Q. Now, the taxes in Texas are not the same for every place, are they?

A. That's correct.

Q. I'll hand you what has been marked Exhibit No. 27 and ask you if you can identify that?

A. Yes, sir, that is our publication (p. 65) called Sales Tax Rates in Texas.

Q. And that's a publication put out by the Comptroller's office?

A. Yes, sir.

Q. And part of the sales tax policy or your group to oversee those publications—get them distributed when people call in; is that right?

A. Yes, sir, that's correct.

MR. GEORGE: I'll offer Exhibit 27.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, Exhibit 27 contains a list of five different tax rates; is that right?

A. Yes, sir.

Q. So that a taxpayer in Texas is subject to different taxes depending upon where they are when they use the product?

A. Yes, sir.

Q. So that if you live in Manchaca—is that what you—you live in Lockhart?

A. Lockhart, yes, sir.

Q. Is Lockhart in the MTA?

(p. 66) A. No, sir.

Q. In Austin?

A. No, sir.

Q. Okay, and if you use a product at your home—but it from out of the state and it's delivered to your house, you're subject to a different tax than if it's delivered to me in Austin?

A. That's correct.

Q. And what's your tax rates?

A. Four and an eighth State, one percent city, for a total of five and one-eighth.

Q. All right, and there are other places that have a half a percent MTA tax and no city tax?

A. Yes, sir, that's correct.

Q. And some places that have a one percent city tax—a one percent MTA tax and no city tax?

As and MTAs?

A. No, sir, cities are all a standard rate of one percent.

Q. Okay. So—but there's a combination of at least five different rates that are possible?

(p. 67) A. Yes, sir, I think five is correct.

Q. Okay. Now, are—when you use a product that is mailed to you at your house, you are subject to the five and an eighth tax; right?

A. That's correct.

Q. Now, if there is a taxpayer who subscribes to *Texas Monthly* and lives in Lockhart, what is their tax rate when they get the magazine?

A. I would suspect that that tax rate is going to be based upon where the publisher is located—not at point of delivery.

Q. Why?

A. Because it is a sales tax normally rather than a use tax.

Q. You have a policy that if something—body mails a—is it the sales tax policy of the State of Texas that if my client mails a magazine to Lockhart the resident in Lockhart pays a 6.125 percent tax because *Texas Monthly's* corporate headquarters are in Austin?

A. Except for the fact that there is an exemption for the MTA tax when the merchandise is mailed from outside

the authority—from inside the authority to outside the authority (p. 68) there is a MTA exemption for that. So the tax rate would be five and an eighth percent.

Q. Okay. That would be the applicable rate?

A. Yes, sir.

Q. Do you know whether or not my client has instructed that they have to collect the 6.125 percent from every Texas subscriber?

A. I don't know.

Q. You don't know that?

A. No, sir.

Q. Okay. Now, you're familiar with various exemptions from sales tax, are you not, ma'am?

A. Yes, sir.

Q. Among the exemptions are exemptions for fertilizer used on farms?

A. Yes, sir.

Q. And other miscellaneous things that are exempt from sales tax; is that correct?

A. That's correct.

Q. You're familiar with an exemption for products purchased by organizations for charitable purposes, are you not?

A. Yes, sir.

(p. 69) Q. Okay, and there is an exemption, is there not, for purchases by educational, religious and charitable organizations?

A. Purchases for their own use, yes, sir.

Q. Okay, but there is no general exemption for their sales?

A. Generally, no, sir.

Q. So that if the Boy Scouts sell things they have to—supposed to collect the tax?

A. With the exception of certain food products, yes, sir.

Q. And if the American Cancer Society which—is that a charitable organization that is exempt when they buy things?

A. Yes, sir.

Q. If they go out and sell things, they have to collect the tax just like exerybody else?

A. Yes, sir, with the exception of the limited exemption that they're entitled to.

Q. And that is for the purchase of goods?

A. The purchase of goods—they're exempt on the purchases, and they're exempt on (p. 70) their sales, if it's a religious, education or charitable organization, for one day. They can have a one-day, tax-free sale. Other than that, they're required to collect the sales tax.

Q. If they have a regular store—Goodwill Industries—

A. Yes, sir.

Q. —it may have an exemption on what it purchases?

THE COURT: Do garage sales have one-day exemption, too?

THE WITNESS: Generally no, sir. No, sir.

QUESTIONS BY MR. GEORGE:

Q. But Goodwill Industries, for example, has a store, and they sell things, and they're supposed to collect sales tax?

A. Yes, sir, they are.

Q. But when they buy things, they're exempt?

A. For their own use, yes, sir.

Q. Okay, and is it the Comptroller's obligation to make decisions on what is or is not exempt, who is exempt, what transactions are exempt?

(p. 71) A. Yes, sir.

Q. Okay, and do you inform—people contact you about exempt transactions?

A. Yes, sir.

Q. Okay, and I believe you've testified during your deposition that people have called you up and asked you about exemptions for religious periodicals?

A. Yes, sir.

Q. And that's something that they've asked you and you've read them the exemption, I believe you testified?

A. That's correct.

Q. And the exemption provides—and I won't quote it but, in essence, that periodicals published by a religious

faith consisting of the teachings of that faith are exempt; is that correct?

A. Yes, sir, I believe that's correct.

Q. And you have periodically informed people that there's such an exemption available, if they choose to use it?

A. Yes, sir.

Q. And I believe there is no system of applying for the exemption, is there?

(p. 72) A. No set procedure, that's correct.

Q. In other words, if somebody thinks they're exempt, they just don't pay the tax?

A. That's one way to do it, yes, sir.

Q. And that there is no system to submit a magazine to you to determine whether it's exempt or not, is there?

A. Other than just sending it in, no, sir.

Q. Has that happened?

A. Magazines, not to my knowledge.

Q. What's been sent in?

A. I think what is sent in normally is the organization itself will give us the name of what is being published and ask us if that particular publication qualifies for a sales tax exemption.

Q. And you decide?

A. No, sir. What we normally do is to see if the organization itself is a religious organization.

Q. And if the religious organization—anything they publish you let come out under that exemption?

A. What we tell them is we leave it to (p. 72) them to decide whether or not it's a religious—a publication or periodical that teaches their faith. We do not make that determination.

Q. Because there's no—you don't have any authority to make it in advance of somebody trying to collect the tax from them?

A. Well, I think it's mainly just because we don't want to get involved in deciding whether something is sacred to a religious faith or not.

Q. But if I go out and say I'm a religious faith and I want to publish a magazine that, I say, is sacred to me and I publish it, I don't have to come to you and get an exemption? I just start publishing it?

A. That's correct. After it's been established that you are, in fact, a religious organization, we do not pursue it any further.

Q. And if it's a religious—and you decide on whether it's religious or not?

A. Tax administration does, yes, sir.

Q. And that's something they look at what people say and how they act and what they do to determine whether they're, quote, a religious faith?

(p. 74) A. There are some guidelines that are set up to determine whether or not an organization is—qualifies as a religious organization.

Q. Ma'am, the exemption for religious organizations is Article—is now Section 151.310; right?

A. Yes, sir, I think so.

Q. And that's a different exemption than the exemption for religious publications, isn't it?

A. Yes, sir, it is.

Q. The religious publication exemption has nothing—doesn't say anything about a religious organization. It says a religious faith, doesn't it?

A. Yes, sir.

Q. And do you follow the statute when you're advising the public about that statute to say to them that it has to have—be published by a quote, religious faith and contain sacred teachings to be exempt?

A. Yes, sir.

Q. You advise them of the content of the exemption?

(p. 75) A. Yes, sir.

Q. When people talk to you about it?

A. That's correct.

Q. And you're aware that there are such publications in Texas?

A. Yes, sir.

Q. And they are exempt, or they don't pay the taxes. You know that, too?

A. Yes, sir.

Q. They don't have to come in and ask your permission to be exempt, but they just don't pay the taxes?

A. That's correct.

Q. Finally I'm going to hand you Exhibit No. 28 and ask if you can identify that?

A. This appears to be something that came off the Comptroller's computer. It looks like it's something that we ran by SIC code, Standard Industrial Classification code.

Q. Okay. I believe that was identified as Exhibit 14 of your deposition, which was—did you order up prior to your deposition a master record of the magazines that are published by Standard Industrial Classification?

A. Yes, sir.

(p. 76) Q. Okay.

A. This is what this appears to be.

Q. Okay, and there is a record in the Comptroller's computer of, at least, magazines that have some contact with the Comptroller that—businesses that say they are magazines, at least?

A. Yes, sir, that's correct.

Q. And Exhibit No. 28 is that list?

A. Yes, sir.

Q. And that is within the capacity of the Comptroller to generate a list of those magazines?

A. Yes, sir, it is.

Q. Okay, and there is a—on that I note an organization called the Baptist Standard. Are you familiar with that?

A. No, sir.

Q. Okay. Do you know whether or not they publish a religious periodical that is sacred to their faith?

A. No, sir, I would not know.

Q. You just don't know?

A. No, sir.

Q. But you're confident that there are such publications in the state?

(p. 77) A. Yes, sir, I am.

Q. And they don't pay taxes?

A. They do not pay taxes, that's correct.

MR. MENDEZ: Okay. I will agree to—or I will not object to the introduction of this exhibit, if we can cover it by a protective order, which I have been discussing with Mr. George here, and I have a motion and order.

MR. GEORGE: If the protective—you mean the identity that these people are?

MR. MENDEZ: Yes, sir.

MR. GEORGE: Let me see what the order exactly says, please. Excuse me, Your Honor.

MR. MENDEZ: And Your Honor, we have filed this motion, and I guess I should give it to you, if I may. Essentially what's happened is there is a taxpayer on that list which we won't name out in the open, but he's in one of those paragraphs, and I think it's on the second page,

and essentially that person has entered into an agreement with the (p. 78) Comptroller through a Multi-State Tax Compact, and one of the provisions of that agreement, which our lawyers at the Multi-State Tax Compact have agreed to, is that we would maintain the confidentiality of his name during the course of any trial that might occur, and Your Honor, this is the provision of confidentiality that applies.

MR. GEORGE: Your Honor, I—as long as it doesn't interfere with the orderly process of this lawsuit, I don't have any objection to the confidentiality order.

MR. MENDEZ: As long as you don't mention him by name and we talk about him, that's fine. I don't care but—

MR. GEORGE: We'll need a code phrase for this company, and the Court will need to be aware of that company's identity to examine witnesses.

THE COURT: Just call it A Company.

MR. GEORGE: Okay. You're aware of the identity of the company at this point?

THE COURT: Let me see. Where is it?

(p. 79) MR. MENDEZ: It's on that thing.

THE COURT: Okay.

MR. MENDEZ: And there's the order, Your Honor.

MR. GEORGE: And I have no objection to the order. Exhibit 28?

MR. MENDEZ: No objection under those conditions.

THE COURT: All right. Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, since July when you gave your deposition, Ms. Hutcheson, have you been privy to any conversations with anybody about finding organizations that solicit orders for magazines or making any investigation of out of state magazines--*Reader's Digest, Ladies' Home Journal,* anybody to determine whether or not they've got representatives in this state and ought to be collecting the tax from Texas readers?

A. No, sir.

Q. Have you been privy or are you aware of any effort to determine whether or not that (p. 80) would or would not produce any money for the State—any net receipts for the State?

A. I have no knowledge or have not discussed that in any way.

Q. Do you know if whether or not there has ever been any effort to determine whether simply a system of encouraging voluntary compliance of a few selective enforcement actions against consumers would induce consumers to pay use taxes that the Legislature has levied?

A. No, sir, I have no knowledge that that's been discussed or done.

Q. Do you know who the Comptroller is—knows whether or not that the system would—some system could not be set up that would produce net revenue, if uses taxes were collected?

A. No, sir. I have no knowledge in that area.

Q. There has been never any system set up, except for getting permits and processing returns from businesses; is that correct?

A. Yes, sir, to my knowledge that's the only way.

Q. That's it?

(p. 81) A. Yes, sir.

Q. And an inexpensive streamlined system for people to fill out and remit use taxes periodically under some system that would operate to collect taxes from people who read magazines where their home office isn't in Texas has never been investigated, looked at, thought about considered topside or bottom. Is that your testimony?

A. That's correct.

MR. GEORGE: Pass the witness.

MR. MENDEZ: Your Honor, we're going to reserve our questioning of this witness until we put on our case and reserve the right to recall her at that point in time.

THE COURT: All right. You may step down.

MR. GEORGE: We'll call Glen Castlebury.

MR. MENDEZ: He is outside of the room.

## GLEN CASTLEBURY

was called as a witness and, having been (p. 82) previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Castlebury, you've previously been sworn, have you not?

A. Yes, sir.

Q. Would you state your full name and address for the record, please?

A. Glen Castlebury, 1611 Sunnyvale, Austin.

Q. Mr. Castlebury, you are an employee of the Comptroller of Public Accounts, are you not?

A. Right.

Q. And what's your position?

A. Associate Deputy Comptroller.

Q. And how long have you been employed by the Comptroller?

A. Ten years.

Q. And what are your areas of responsibility as Associate Deputy Comptroller?

A. Well, I have administrative jurisdiction over several divisions, including our Tax Publications Division, Research Division, (p. 83) Tax Information Division and Support Services Division.

Q. All right. Can you give the Court some idea of what the structure of the organizational chart of the Comptroller's office is? Mr. Bullock is the Comptroller, and who serves under him as his next in command?

A. The next in command is the constitutional office chief clerk. We call it Chief Deputy Comptroller, and that job is held by Mr. Jack Roberts. Under Mr. Roberts then there are eight, I believe it is, Associate Deputy Comptrollers, and underneath we eight Associate Deputy Comptrollers are spread out the various operating divisions of the office.

Q. Okay, and your duties include information to the public about the tax policies involving sales tax?

A. Right. Basically anything that goes out of our office to the public, whether it's a form or a policy announcement, a publication or—if it goes out to the public, then it comes across my desk.

Q. Have you been involved in discussions and policy decisions concerning the (p. 84) enforcement and collection of the sales and use tax for the ten years you've been employed by the Comptroller?

A. Yes, sir.

Q. Now, were you employed by the Comptroller in that position with responsibilities involving the implementation of the Legislative changes that became effective on October 2nd, 1984?

A. Yes, sir.

Q. Included adding magazines to the list of taxable items?

A. Yes, sir.

Q. Now, can you tell the Court what sort of efforts were made to inform the public regarding the need to remit and pay taxes for newspapers, for example?

A. Well, we contacted by direct mail every newspaper in the State of Texas and worked through their trade associations, Texas Daily Newspapers and Texas Press Association. I met with publishers across the state in several meetings.

Q. All right. Was there any effort to contact magazine publishers or magazine users, (p. 85) magazine readers?

A. No.

Q. Okay. Was there efforts to contact the dry cleaning industry that became subject to tax?

A. Yes, sir.

Q. Was there efforts to contact everybody else that became subject to tax except magazines?

A. Yes, sir, there was.

Q. And there was no policy, no effort to attempt to start collecting a tax on magazines, at all, was there?

A. Only as they were a part of the general public.

Q. All right. Now, one of the things in this case involves taxes on—the use tax. Do you understand that the tax—the use tax is levied on all users of taxable property?

A. Correct.

Q. And it doesn't matter whether you're a business user or a non-business user?

A. Correct.

Q. If you use an item that you didn't pay taxes on for some reason that is taxable (p. 86) you owe the tax?

A. Correct.

Q. And that if your wife goes off to New York and asks for a department store up there to send her something by mail or orders it by mail, she's obligated to pay taxes on that if it's a taxable item?

A. Correct.

Q. Now is it true that the Comptroller's office has never made any effort to collect the tax from Texas consumers for those use taxes?

A. For those use taxes, as you just described, that's correct. No effort has been made.

Q. Now, for magazine readers—you understand that people read magazinees, I take it?

A. Right.

Q. Do you read magazines?

A. Yes.

Q. Do you subscribe to some magazines?

A. Yes.

Q. Do you subscribe to some out of state magazines?

A. I have to assume it's out of state.

(p. 87) Q. Which one is that—*Reader's Digest* or—

A. *Southern Living, Sesame Street.*

Q. *Sesame Street*?

A. It's not mine. I read it to him, Judge.

Q. Do you remit a use tax on those products?

A. No, sir.

Q. Do you understand that a use tax is due?

A. Yes, sir.

Q. Is there an intentional policy on the part of the Comptroller's office not to collect use taxes from consumers on out of state magazines?

A. Yes, sir.

Q. And has there been discussions of the political impact it might have to enforce the use tax law as written? Have you ever sat down with Mr. Bullock and other Associate Deputies and said, "Now, what could we do to enforce this use tax as written, and what would be the political consequences?"

A. No, we have not. We've had members (p. 88) of the public in some instances talk to us about it, and in that situation we talked about—with them about the ludicrousness of the idea of trying to go into everybody's home and collect on their items.

Q. Well, the Legislature has passed this law that requires the collection of those taxes, hasn't it?

A. Correct.

Q. And the administrative officers simply decided that really isn't a particularly effective or a good way to do it and chose not to enforce it, haven't you?

A. That's about the way it comes down, yes.

Q. And you understand that the—that decision operates to discriminate against Texas magazines in this instance; that is, if my client publishes *Texas Monthly* here in Texas and your people come to their offices and make them pay them money out of their receipts for magazine sales, they have to pay it, but you read *Sesame Street* or the people who choose to read some other magazine don't pay it, and that discriminates against those readers and those (p. 89) businesses? The Comptroller is aware of that?

A. Yes, sir.

Q. And despite that, simply chose not to collect the tax?

A. That's correct.

Q. And Mr. Castlebury, it's true, is it not, that the Comptroller's office has never tried any system of investigating the economics of trying to collect the use tax to get people to voluntarily remit their use tax?

A. I wouldn't say that we've never tried to investigate it.

Q. Done any—

A. It doesn't seem like it requires a great deal of in-depth investigation.

Q. Well, there is—we used to have a system of voluntary rendering of property—of all kinds of property. Still do have a system of voluntary rendering of property subject to the local ad valorem taxes. It's a voluntary system of compliance. You're aware of that?

A. Right.

Q. And there are various publicity campaigns and other things that take place to get people to render their property on time and (p. 90) pay their taxes and that sort of thing. Has any system of encouraging voluntary rendering of use taxes ever—from our consumers ever been—"We could spend one million dollars on publicity and hope to generate a million dollars return" or any other kind of sit down with a pencil and a calculator and figure out—

A. True. Yes, because this is the basis of the audit program which becomes a basis of all voluntary tax compliance—that there is a—our audit program, which we'll do 25,000 audits this year, I believe, and in each audit a use tax would be picked up.

Q. But there's never been applying that—that's only businesses that get audited, aren't they?

A. That's true.

Q. And only the business—if you have a business, you get audited, but if you're a State employee or somebody else who doesn't have a sales tax permit and he's not in the business of selling anything or is not in business generally, you don't ever get audited?

A. That's right. If you're not in the business of selling—if you're not generally (p. 91) in the retail business and if you don't have a sales tax permit, no, you would not be audited.

Q. And there's no—and it's intentionally decided not to enforce the use tax against consumers?

A. Correct.

Q. Now—and no economic study has ever been done whether or not that's going to be a good thing for the State?

A. No, not in what terms, as I would understand, what you use with economic study, no.

Q. Okay. Now, has there been an effort to send people out to find publishers generally, ferret out folks that owe taxes and send them out—auditors out in the state looking for publishers in the state that might have to pay the taxes?

A. No.

Q. Now, you got a subpoena, did you not to come here?

A. Correct.

Q. Did you bring the documents that you were subpoenaed to bring?

A. Right. I brought the only document I found in my files that seemed to fit the (p. 92) description.

Q. Could I see those, please, sir?

A. Yes.

Q. Are these copies that we could mark?

A. Yes.

Q. You have an original?

A. Yes.

(At this time instruments were marked as Exhibits Nos. 29 and 30 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Mr. Castlebury, there was—you had some meetings with Mr. Gerhart of *Texas Monthly*, didn't you, in the fall of 1984?

A. Correct.

Q. And he brought to your attention a list of publishers he believed had offices or sales people in Texas that were out of state people, did he not?

A. Correct.

Q. And did your office do anything to collect taxes from those people?

A. Not specifically.

Q. Did you take the list of people that Mr. Gerhart gave you and do anything with them (p. 93) at all?

A. I did not, no.

Q. Do you know if anybody else did?

A. I'm not aware that they did.

Q. Did Mr. Gerhart inform you that there were magazine order takers, solicitation people that went around from door to door taking orders for magazines?

A. Correct.

Q. And did he tell you that school children often did that?

A. He did.

Q. Did you get a memo regarding that from Ms. Wanda Hutcheson?

A. Right.

Q. Did you decide that the Comptroller would not do anything—this has been marked Exhibit 26 and is a copy of something you produced?

A. Right.

Q. You received Exhibit 26, did you not?

A. Right.

Q. Did you participate or make a decision not to take steps to try to collect the taxes from magazines that have door to door (p. 94) solicitors or use school children in Texas?

A. Correct.

Q. And what was the purpose of that decision? What was the reason for that decision?

A. Well, we just felt it would be absolutely absurd to go around to these youth groups—these children and people we didn't even know where they are or who they were or what they were doing.

Q. That you would—if you went out to the school kids and found out that *Reader's Digest* or other people were taking orders through those school kids, you could have gone to *Reader's Digest,* couldn't you, and seen if they had somebody taking orders here in Texas through Texas school children, but you chose not to do that?

A. Right.

Q. And you intentionally chose not to do that?

A. Correct.

Q. And you understand that hassling the school kids or other things might be controversial? I'll put it that way.

A. Well, it's not so much controversial; (p. 95) although, it certainly would be, but it would just be ludicrous. It's not at all in keeping with the way we run our office and the efficiency of how we raise the dollars we raise.

Q. And even though in this instance you're aware that the system produces discrimination against Texas publishers, you choose not to do it because it simply wouldn't be a good idea?

A. Correct.

Q. Now, I'll hand you what is Exhibit 29 and Exhibit 30 and ask you if you can tell the Court—those are items you produced in response to the subpoena; is that correct?

A. Right.

Q. Can you tell the Court what those are?

A. Exhibit 29 is a letter from Comptroller Bullock to Harry Gerhart of *Texas Monthly*, which the Comptroller issued following the meeting that Wanda Hutcheson and I had with Mr. Gerhart, and the Comptroller in this letter just simply announces that he is not going to take the liberty to rule the tax unconstitutional, and that he has asked the Attorney General that (p. 96) question, and we would just wait and see, and it has a line in there that says, "In the meantime we will expect to see magazines complying with required reports and payments as the newspaper industry is."

MR. GEORGE: I'll offer Exhibit No. 29.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. And what is Exhibit 30?

A. Exhibit 30 is no more than a weekly status report from one of our Associate Deputy Comptrollers at the time to Mr. Bullock, in which a reference was made on one page that Wanda Hutcheson and Mona Shoemate met with employees of *Texas Monthly* magazine about their assertion that the tax on magazine subscriptions is unfair to Texas. The Associate Deputy that wrote that didn't probably—maybe didn't know—I don't know whether I would inform Mr. Bullock about Wanda and Mona's meeting or not.

Q. Have you discussed that with Mr. Bullock himself?

A. Yes.

(p. 97) THE COURT: Has this one already been admitted?

MR. GEORGE: I'm sorry. I'll offer Exhibit 30.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, do you recall whether or not Mr. Gerhart supplied some numbers of his determination of what he thought could be raised in the way of revenue from out of state publishers?

A. Yes, he did.

Q. Okay. By the way, can you tell the—do you know how much the total dollars are raised from the sales and use tax, as it is now enforced in Texas for the last biennium or current biennium approximately?

A. Yeah, let me think a minute. Sales and use tax ought to bring in about 9 billion dollars this year.

THE COURT: Is this sales and use tax combined?

THE WITNESS: Yes, sir, Judge: If I'm right, it would be.

(p. 98) THE COURT: Is there any way of separating it out—from out of state, in other words?

THE WITNESS: Yes, sir, we know—we have a way—we know what we get from out of state, as compared to what we get from in state addresses, yes, sir.

QUESTIONS BY MR. GEORGE:

Q. Do you know what—when someone remits a sales or use tax, do they remit it as a sales tax or a use tax, or do they just remit it under the general statute?

A. The sales tax forms have one line for taxable sales, which is their sales tax. It has another line for use tax purchases—their purchases. So, yes, we can break it out.

Q. Okay. Do you keep—but your 9 billion dollars is the sum of what you sold that was taxable and collected from the buyer?

A. Right. If I'm correct on the number—and that bears checking, but the number I would have intended to use would have included both.

Q. Now, the total collected from magazines or that could—well, first of all, has the Comptroller done some sort of projection (p. 99) of what might be collected from magazines or newspapers or either one of those people?

A. Yes, sir, there was a quickie sort of off-the-cuff projection made in the waning days of the 1984 special legislative session.

Q. Is this a significant amount of money in terms of the budget of the State of Texas?

A. Not to the budget of the State of Texas.

Q. Now, in your subpoena there was a request for you to bring documents and correspondence and memorandum generated by the Comptroller's office relating to the collection of sales and use taxes from non-business consumers including but not limited to people who subscribe to magazines purchased by out of state publishers or from out of state publishers. Have you done that?

A. I had no documents to bring.

MR. GEORGE: Okay. I pass the witness.

MR. MENDEZ: We'll reserve our questions under the same criteria.

THE COURT: Well—

(p. 100) MR. MENDEZ: I'm going to put on a case when he rests, and I want to explain what the Comptroller's office does, and you know, I'll put on my witnesses so I can put on an orderly presentation is what I'm saying.

THE COURT: Well, I can understand that with your representative here, but are we going to do it on every Comptroller witness?

MR. MENDEZ: Well, I intended to, but, you know, if there's some problem with that—

THE COURT: Well, as long as it doesn't get out of hand, I guess.

MR. GEORGE: Your Honor, it's just a matter of timing. I don't want to take forever to try this lawsuit, but I don't mind him calling people back. If he wants to call Mr. Castlebury back, that's fine. If that's what he's saying, I don't have any—

MR. MENDEZ: That's what I'm saying is—

THE COURT: You can call him back.

MR. MENDEZ:—it doesn't (p. 101) bother us to do that, and so we'll be glad to do it that way.

THE COURT: If you're going to call him back just on your defense in chief, fine.

MR. GEORGE: I'm through with him, and he can be excused from the rule, as far as I'm concerned at this point, but that's up to Mr. Mendez.

MR. MENDEZ: Well, if he doesn't have any problem, he can stay through here. That's fine with me.

THE COURT: Now, of course, you can't use him again.

MR. MENDEZ: Oh, well, I thought he was—

MR. GEORGE: No, he can use him again, if he wishes to.

THE COURT: No, no, I'm talking about on the rule.

MR. GEORGE: I will waive the rule, as far as Mr. Castlebury. If Mr. Castlebury wishes to stay, I will waive it as for this one witness.

THE COURT: All right.

(p. 102) MR. MENDEZ: Do we want to have that same—for the rest of them—that I've got—you're going to call a bunch more of my witnesses, but as I understand, all of the rest of them will remain under the rule?

MR. GEORGE: I'll have to make that decision and see what you do, Mr. Mendez.

MR. MENDEZ: That's fine.

MR. GEORGE: I would like to call Mr. Glen Schankle.

GLEN SCHANKLE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name—you have been sworn?

A. Yes.

Q. Would you state your name and address, please?

A. Glen Schankle.

Q. Mr. Schankle, what's your address?

(p. 103) A. 111 East 17th Street, LBJ State Office Building.

Q. And how are you employed, Mr. Schankle?

A. I beg your pardon?

Q. How are you employed? What's your job?

A. I'm Associate Deputy Comptroller for the Enforcement Division at the Comptroller's agency.

Q. And does the Associate Deputy Comptroller enforce—in charge of enforcement the person who goes out and enforces taxes against people who don't pay them voluntarily?

A. Does he actually do that? No, I administrate that.

Q. That's under your supervision?

A. Yes, sir.

Q. How long have you been employed by the Comptroller?

A. Nine years.

Q. And has your job with the Comptroller been in enforcement the whole time?

A. No, sir.

Q. Okay. How long have you been in (p. 104) enforcement?

A. Five months.

Q. And what were you before that?

A. I was Associate Deputy Comptroller of the Revenue Management Division.

Q. Have you, during your tenure as the supervisor of the Enforcement Division, supervised any effort to en-

force the use tax obligation on consumers to pay use taxes on products they buy from out of state?

A. I'm going to answer that in a way that—your question is really not clear to me.

Q. Do you want me to rephrase the question?

A. Yes, right.

Q. All right. Let's assume that a non-business person—my wife goes to New York, goes to a department store and orders some stuff and has it sent to her by mail. You understand she owes a use tax on those dresses; is that right? You have to answer verbally.

A. Yes, sir.

Q. Okay, and it's my understanding that the Comptroller has never gone out and tried to collect taxes from such people who buy things (p. 105) out of state?

A. From individuals?

Q. Yes, sir.

A. No, sir.

Q. You only do it if you have a—if you're a business and have a permit?

A. That's correct, sir.

Q. And you simply choose not to enforce the law the Legislature wrote?

A. No, that's not correct.

Q. Well, you could go out and enforce that law, couldn't you?

A. We could, yes.

Q. And you don't do it?

A. Well, not in that particular case, we don't do it.

Q. You don't do it as my wife or anybody else who buys from out of state—user—products from out of state, do you, unless they're a business?

A. Not correct.

Q. Do you enforce it against people who buy magazines from out of state?

A. No, sir. We do conduct random canvasses of the business community, which could (p. 106) pick up those individuals.

Q. For businesses again?

A. For the—

Q. Do you—do you subscribe to any magazines?

A. No, sir.

Q. Not one?

A. No, sir.

Q. Mr. Levy will be very—the owner of *Texas Monthly* is always sorry to hear about people who don't read magazines, but I hope you buy some from the newsstand. Do you know anybody who subscribes to magazines?

A. Yes, sir.

Q. Do they remit use taxes on out of state—

A. Not to my knowledge.

Q. And you know that?

A. Yes, sir.

Q. And despite knowing that, you don't do anything about it, although the Legislature has passed a law that said they have to do it?

A. No, sir.

Q. You just don't do it?

A. No, sir.

(p. 107) Q. Is there any other laws the Comptroller ignores?

A. Well, there is no laws that we ignore.

Q. You ignore the obligation for consumers to pay the use taxes on out of state magazines.

A. Well, that depends on how you value the collection of taxes.

Q. Yes, sir, but you—the Legislature made a decision that those transactions were taxable?

A. That's correct.

Q. And you have decided, in the wisdom of the Comptroller's office, to not honor—not go out and try to collect them and see what happened?

A. No, there was no decision made not to.

Q. You just don't do it?

A. When time allows, we will do it.

Q. And you've been there ten years, and it hasn't been done yet, has it?

A. Not to my knowledge.

Q. Do you have any plans of getting (p. 108) around to it sometime?

A. Not in the near future, no.

Q. You have never even discussed it have you, Mr. Schankle?

A. Randomly.

Q. Randomly discussed it?

A. Right.

Q. But you've never actually gone out and tried to collect the taxes at all, have you?

A. On the particular situation—

Q. On consumers who buy products?

A. No, sir.

Q. You know they're taxable, but you just ignore it?

A. Well, I'm not going to go for the word ignore.

Q. You just don't do anything about it?

A. Not at this time.

Q. Yes, sir. Okay. Now, have you ever had someone come to your home soliciting to sell you magazines?

A. Yes, sir.—

Q. Did you look at the magazines for which orders were being taken?

A. Yes, sir.

(p. 109) Q. The list? Lots of magazines on that list, weren't there?

A. That's correct.

Q. And they were asking you to order those magazines, weren't they?

A. That's correct.

Q. And they were asking you to order them from out of state?

A. That's correct probably.

Q. Okay. Did you do anything to go to those out of state publishers and make them pay taxes when they had an agent in Texas soliciting orders?

A. Well, the agent was, number one, unidentifiable in the particular situation that I'm thinking of.

Q. Unidentifiable? He was standing there in front of you at your door.

A. Yeah.

Q. And you knew he was taking orders for magazines to be sold to Texas residents and that you were a Texas resident?

A. It was a young kid or a teenager with a portable credit card pouch and a list of magazines. So I didn't feel it was necessary to (p. 110) investigate where he came from or who he was selling it for.

Q. Well, he opened up the brochure and showed you that there was Ladies Home Journal and all sorts of magazines on that list?

A. That's correct, and at that time I told him I wasn't interested.

Q. Yes, sir. Did you go back to your office and see whether those magazines were remitting sales tax for sales to Texas residents?

A. No, sir.

Q. In fact, you know they're not, don't you?

A. Not to my knowledge.

Q. Now, you haven't checked since this lawsuit came up to find out?

A. No, sir.

Q. Do you know if anybody has?

A. Not to my knowledge.

Q. Do you know whether magazines such as Reader's Digest and big ones like Reader's Digest and Ladies Home Journal and others are paying their taxes?

A. I'm familiar with a couple of cases I'm not familiar with the name of the magazine— (p. 111) just through hearsay—office talk I've heard where there have been some cases that magazines have remitted some tax.

Q. Some tax?

A. Yes.

Q. Now, are you aware of a representative of Texas Monthly bringing to the Comptroller a list of magazine publishers who circulate and sell magazines to Texas residents who have representatives in this state? Those magazines have representatives in this state, according to Texas Monthly at least, and who have solicitors in this state and told the Comptroller that those people have representatives and asked them to go out and try to collect the

taxes from these people—make them collect sales taxes from their readers?

A. No, sir, I'm not aware of that.

Q. Nobody has told you that?

A. No, sir.

Q. You're in charge of the Enforcement Division?

A. That is correct.

Q. Now, how would we go about getting the sales tax—obligation to collect sales tax (p. 112) enforced against out of state magazines? Would that have to go through you?

A. Yes, sir.

Q. So if the Comptroller decided that since Texas residents were ordering *Reader's Digest* or some other magazine through door to door solicitors that was enough to make *Reader's Digest* obligated to collect the tax from Texas residents, that would have had to have gone through you?

A. Technically, yes, but not all of the time, no.

Q. Well, you were in charge of the department that would do it?

A. That is correct.

Q. But it hasn't happened?

A. Not to my knowledge.

Q. Are you aware of any enforcement activities that have taken place to enforce other tax changes that took place—became the law on October 2nd, 1984?

A. Yes, sir.

Q. What has happened?

A. We've conducted canvasses once again of the business community to determine who those (p. 113) people are—to notify them.

Q. Who the people are? You mean, dry cleaners?

A. Dry cleaners.

Q. Massage parlors?

A. Massage parlors, dance halls.

Q. Turkish baths?

A. I beg your pardon?

Q. Turkish baths?

A. Yes, sir, along those lines.

Q. Pool halls?

A. Yes, sir.

Q. All of those people you've gone out and tried to collect the tax from?

A. Tried to collect the taxes, number one. Two, being to notify them that they do fall under the new tax law.

Q. Magazine readers you haven't done anything about?

A. Not to my knowledge, sir.

Q. And you knew you were't doing anything about it, and despite that, didn't do it at all; is that right?

A. Do you want to rephrase that, please?

Q. Well, you knew you weren't making (p. 114) any effort to collect the tax from magazine readers or magazine publishers who had some contact with Texas, except Texas based publishers like *Texas Monthly?*

A. Is that comparisons to the pool halls?

Q. Well, you went to pool halls. You sent somebody to the pool halls and told them to pay the tax, didn't you?

A. There was a purpose for doing pool halls or whatever, you know, you want to categorize those people as—not to do certain other areas.

Q. Well, somebody decided not to send somebody out to enforce the tax against magazine readers that read magazines from out of state publishers?

A. That is correct.

Q. And they didn't do it, but you did it for all of the other industries except this one; isn't that right?

A. Well, I'm not—no, that's not correct. I'm going to say that's not correct because there are probably some other areas out there where—automotive shops or whatever the (p. 115) case may be we may not have gotten around to, as well.

Q. Do you have any plans to get around to magazines?

A. Not in the near future.

Q. In fact, you don't have any plans near future or long-term future, do you?

A. Well, I can't answer that question.

Q. Well, you don't know of any, do you?

A. I can't answer that question. It depends on the time that we have to get around to concentrate on the magazine industry.

Q. You might get around to it some day, but you don't have any idea when that might be?

A. No, sir.

Q. All right. Did you get a subpoena to come here today?

A. Yes, sir.

Q. Did you look for the documents that were listed in the subpoena?

A. Yes, sir.

Q. The documents that were supposed to involve efforts by the Comptroller to collect taxes from out of state publishers and readers of the magazines published by out of state?

(p. 116) A. That is correct, sir.

Q. Did you look for those documents?

A. Yes, sir.

Q. Are there any such documents?

A. No, sir.

Q. Now, you understand that if you go about collecting taxes from the business community and you raid somebody's—send a bunch of enforcement officers down there and get some stories in the newspaper about the need to

pay taxes on pool halls that gets—encourages compliance, doesn't it?

A. That is correct.

Q. And you understand you don't have to go to every pool hall and raid them to encourage people to submit their tax returns?

A. That's correct.

Q. And despite knowing that you don't have to go to every consumer to encourage people to file their—to pay their use taxes on consumer products that they purchase and don't pay their taxes on them, you haven't done that at all, have you?

A. Could you run that by me again, please?

(p. 117) Q. Yes, sir. You know that if you enforce one or two times in a highly visible way the obligation to pay a tax against someone who's supposed to pay it, it encourages that person and others who hear about it to pay the tax?

A. That's correct.

Q. And you could do that against consumers who buy products subject to the use tax that don't pay the tax?

A. That's correct.

Q. But you choose not to?

A. We haven't.

Q. And has—are you familiar with any effort by the Comptroller to make any kind of organized decision about what sort of voluntary compliance, what sort of compli-

ance at all could be had to get consumers to pay use taxes on out of state publications?

A. No, sir.

Q. Do you understand that under the present system readers of *Texas Monthly*—part of what they send in has to be sent in for taxes, where people who read other magazines sent in from *Reader's Digest* don't pay the taxes?

(p. 118) A. Yes, sir.

Q. You know that's going on?

A. Yes, sir.

Q. And you don't do anything about it—haven't done anything about it?

A. Haven't.

Q. But you may do it someday?

A. May.

Q. If you get around to it?

A. That's correct.

MR. GEORGE: Pass the witness.

MR. MENDEZ: We have no questions for this witness.

THE COURT: You may step down.

THE COURT: If you've got something for five minutes, we can take it up. Otherwise, we can recess for a lunch break now.

MR. GEORGE: It won't be much more than five minutes.

THE COURT: All right. Let's try it.

MR. GEORGE: Dale Craymer.

THE COURT: Were you sworn (p. 119) earlier?

THE WITNESS: Yes, sir.

MR. MENDEZ: Well you were sworn for the deposition.

THE WITNESS: Oh, okay.

DALE CRAYMER

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Dale Craymer, 4604 Elwood Road, Austin.

Q. And how are you employed?

A. I am the Director of Revenue Estimating for the State Comptroller.

Q. During the course of your work, have you had an opportunity to make an investigation, determined from the best evidence you can, which companies, if any, are paying sales taxes on magazine subscription sales?

A. Yes, I have.

(p. 120) Q. Was that done as part of your preparation for this case?

A. Yes, it was.

(At this time an instrument was marked as Plaintiff's Exhibit No. 31 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Did you have an opportunity during that study to make an effort to determine approximately how much money you predicted would be collected from—under the current compliance system from all magazines that are collecting the tax and paying it?

A. How much we expected we were collecting, yes.

Q. Okay, I'll hand you what's been marked as Exhibit 31. Can you identify that?

A. Yes, it is—it was some information that I had prepared and had turned over to David Mendez concerning those publications—or the companies we expected had been remitting tax on magazine subscriptions.

MR. GEORGE: I'll offer Exhibit 31.

MR. MENDEZ: No objection.

(p. 121) THE COURT: Admitted.

QUESCTIONS BY MR. GEORGE:

Q. Now, Mr. Craymer, you are the person who is responsible for determining how much money is to be collected by the Comptroller's office from various kinds of taxes?

A. That's correct.

Q. That's your job?

A. Yes, sir.

Q. And you were also asked to determine how much money—or who was paying the sales and use tax on magazine sales?

A. Yes.

Q. And you instituted a procedure to do that?

A. Yes.

Q. And you came up with the list that's on Exhibit 31?

A. Yes.

Q. And that's all of the people you could find that were paying the tax?

A. That we—yes.

Q. And you used the best techniques you had available to you to do that?

A. Yes.

(p. 122) Q. All right, and you then set about the process of estimating what you think you were collecting from magazine sales tax payers, that is, publishers who are supposed to remit sales tax—or who are remitting sales tax? I rephrased that question.

A. Yes.

Q. And for the publishers who are remitting the sales tax, you have determined that approximately $1,400,000 a year is being remitted?

A. That was an earlier estimate. At the time of the deposition, I was asked to update that.

Q. Have you done so?

A. Yes, sir, I have.

Q. Is it different?

A. Yes, it is.

Q. What's the difference?

A. We estimate that it's approximately 2.5 million.

Q. You're changed your estimate?

A. Yes, sir.

Q. Have you got any more people paying the tax?

(p. 123) A. No, it is based on the same list of taxpayers.

Q. Okay. Same 20 or 30 people that are—companies that are on that list?

A. Yes, on the exhibit.

Q. Okay, and so you now estimate that those companies will remit—what—two—

A. We estimate that they have remitted 2.5 million for—

Q. Is that since October or—

A. Yes.

Q. Is that an annualized basis?

A. It's from October to August 31st, the first fiscal year the tax was in effect.

Q. Is your—are you estimating what they will remit on a fiscal year basis, or are you reporting what they did remit in the first—

A. I'm reporting what they did remit during the fiscal year 1985.

Q. Okay. Have you an estimate of what they will remit during a complete fiscal year?

A. I have not prepared one.

Q. Okay. So you don't know that?

A. Yeah. Well, you could make a reasonable assumption based on the nine months (p. 124) of information that we have.

Q. Somewhat more than the two—

A. 2.5, yes.

Q. —2.5. Okay, and you have done the best job you can in finding the people who are going to pay the tax—or who have paid the tax in the last year?

A. In identifying the ones that we believe, yes.

Q. I believe that you are a magazine reader; is that right?

A. Yes.

Q. And you read Texas Monthly, as I recall?

A. Well, parts of it, yes.

Q. Well, you subscribe to it?

A. Yes, I do.

Q. That's almost as important as reading, and you subscribe to other magazines?

A. Yes, I do.

Q. And you subscribe to out of state magazines?

A. I imagine some of them are.

Q. And you understand there's a use tax due on those subscriptions?

(p. 125) A. Yes, I do.

Q. And you don't pay it?

A. I do not have any—no, I do not pay it. If—I'm not sure which magazines I subscribe to are out of state. So I'm not sure exactly which ones I would be required to pay the tax on.

Q. Are you aware of any way you could pay it, if you wanted to pay it?

A. Well, occasionally on subscription flyers it will state that the subscription price includes sales tax.

Q. You've seen that?

A. Yes, I have.

Q. But you—I'm talking about an obligation to pay a use tax—your obligation to pay a use tax yourself to the State. You are the chief revenue estimator for the State of Texas, are you not?

A. Well, I'm director of Revenue Estimating.

Q. And do you know of any way that you as a citizen can, in fact, remit use tax when you buy something from out of state? Is there a procedure existent that you know of, as for a (p. 126) consumer to send in the use tax that he owes?

A. I have no direct knowledge of one, but I have heard that we do receive checks occasionally in revenue processing that just come in, and there is no stated purpose behind the check, and we expect that some of those are use tax checks.

Q. There may be some people who will send in because the Legislature has enacted a law that requires them to do so, but the Comptroller has not promulgated any system to collect it; is that right?

A. I do not have any direct knowledge of one.

MR. GEORGE: Pass the witness.

MR. MENDEZ: We'll reserve our questions.

THE COURT: All right. You may step down. Gentlemen, I have a brief 1:15 hearing, which should be complete at 1:30. So we'll recess this hearing until 1:30.

(At this time a lunch recess was taken, after which time the proceedings continued as follows:)

(p. 127) MR. GEORGE: Harold Lee.

THE COURT: You were sworn earlier?

THE WITNESS: Yes, sir.

HAROLD LEE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Lee, would you state your name and address for the record, please?

A. My name is Harold Ray Lee. My business address is 111 East 17th Street, Austin, Texas.

Q. Are you an employee of the Comptroller of the State of Texas?

A. Yes, sir.

Q. And at the time you gave your deposition, you were head of the Audit Division; is that correct?

A. Director of the Audit Division, sir.

Q. Okay, and you have been, in the course of your career, head of the Enforcement (p. 128) Division, as well, have you not, sir?

A. Yes, sir.

Q. And is the Audit Division the division charged with going out and auditing a company to determine whether or not they are obligated to pay taxes or paid their right amount of taxes?

A. Yes, sir.

Q. How long have you been associated with the Audit Division?

A. Nearly 13 years.

Q. During that course of that time, does the Audit Division make a regular practice of auditing consumers who buy products that are not businesses?

A. Would you restate that, sir?

Q. I'll try. I don't have a sales tax permit, but I buy things. I'm a consumer, as you are. I assume you don't have a sales tax permit?

A. No, sir.

Q. But you do buy things?

A. Yes.

Q. And you become obligated to pay a use tax on some things?

(p. 129) A. Yes.

Q. And you are a consumer?

A. Yes.

Q. Have consumers, such as yourself, been audited in the 13 years you've been there?

A. No, sir.

Q. And have you intentionally not audited consumers?

A. No, sir. Well, yes, sir. Excuse me.

Q. You intended not to do that?

A. That's correct.

Q. And you are aware that the Legislature decided, in its wisdom, to have a tax—a use tax on consumers, as well as a use tax on businesses?

A. Yes, sir. If I could add, I think they also would want us to be expedient in the job we do and the collection of the taxes, and auditing all of the consumers such as myself would be pretty much cost prohibitive.

Q. Are you aware of the studies that—any studies ever been done of any—any way that could be implemented to try to get voluntary compliance from consumers who owe use (p. 130) taxes?

A. No, sir.

Q. No study has ever been done, have they, with the Comptroller?

A. I have no knowledge of that, sir.

Q. You make an assumption that there is no way to collect use taxes from even the wealthiest consumers and make no effort to do it, have you?

A. There is a program we're looking at right now that may address this issue. People bringing in things from foreign countries where we look at export declarations at the airports where we can key in on higher dollar volume—

Q. You're thinking—

A. —items.

Q. Excuse me.

A. Where we can key in on higher dollar volume items.

Q. You're thinking about doing that?

A. We have a—the right with the U.S. Customs to do it. We just have not been able to get our people into their facility yet.

Q. Haven't done it yet?

A. No, sir.

(p. 131) Q. Thinking about doing it to collect a use tax on consumers?

A. Looking at the feasibility of it, yes, sir.

Q. Okay, but that's the only inquiry that's ever been made, isn't it, sir, in the 13 years you've been associated with the Audit Division?

A. I've not always been in a management position with the Audit Division. In the last three or four years I don't know of any studies.

Q. Okay, and—

THE COURT: I have a question here.

MR. GEORGE: Certainly.

THE COURT: You're talking about import from foreign countries. You mean they've ordered it shipped into here or—

THE WITNESS: No, sir. It's coming in in their baggage.

THE COURT: Coming in their baggage? I guess I'm confused. How would that apply? Have I got to pay a—supposedly does the law require me to pay a tax, if I buy something while I'm traveling in England—a Texas (p. 132) tax?

MR. GEORGE: If you use it in Texas.

THE COURT: In other words, if I buy me a sweater in Scotland—

MR. GEORGE: The Legislature—

THE COURT: —and I come back and wear it here, I'm supposed to pay a tax.

MR. GEORGE: That's what the Legislature—

THE WITNESS: Yes.

QUESTIONS BY MR. GEORGE:

Q. That's what the Legislature has declared the law to be, isn't it?

A. Yes.

Q. That's the law in this state?

A. To my understanding, yes, sir.

Q. And that's so that anybody who uses—if you bought the sweater at Merritt, Schaefer & Brown, you're obligated to pay sales tax when you buy it to Mr. Merritt, Schaefer and Brown; is that correct?

A. Yes, sir.

Q. And if you buy it in Scotland and (p. 133) bring it back to the United States, you're obligated to pay—to Texas and store it or use it, you are obligated to pay a use tax?

A. From a foreign country, I don't know if they have a sales tax, but we would honor another state's reciprocal tax, if it was paid there and brought in.

Q. If you buy something in New York and you can show you paid their sales tax, if they have a sales tax, you can get a credit for the tax you paid in some other state?

A. That's correct.

Q. But subject to getting the credit you owe use taxes?

A. Yes.

Q. And that's the statutory obligation of every Texas resident?

A. Yes, sir.

Q. And the Comptroller has decided, in its wisdom that despite the statute it's not going to enforce that obligation?

A. I don't think we can with the manpower we have and the cost of it to do so.

Q. You think you have good reasons for not doing it, but you have decided not to (p. 134) enforce it—the statute?

A. Yes, sir.

Q. Okay, and you understand that that decision to not enforce it operates to discriminate against clients such as mine who mail things to Texas residents and they have their headquarters in Texas and compete with magazines mailed from New York to Texas residents?

A. Yes, sir, I understand there is a—some discrimination there.

Q. And that—the Legislature has enacted a statutory system that, if enforced, would not discriminate, but you choose not to enforce the statutory system because you don't think you can operate that way. It won't be effective. So you choose to operate the system in a discriminatory manner—the tax system?

A. Well, I think it would be ill advised to operate it where we spend more money than we collect.

Q. Yes, sir, but the Legislature has enacted the statute. For good or evil, that's the law is it not?

A. Yes, sir.

(p. 135) Q. And the law, if enforced and everybody paid the use tax they owed, would not discriminate, but you choose to enforce it in a way that you know discriminates?

A. I assume so.

THE COURT: The way—Counsel, it seems the way you're arguing—or the question is going, Counsel, is that the—all use tax would be unconstitutional?

MR. GEORGE: No, sir. If they have an obligation to pay the use tax on that sweater and they choose not to enforce it, that's an act on the part of the Comptroller to not enforce a valid law, and if they have an intentional plan not to enforce the law and it operates to hurt somebody under Article 8, Section 1 of the Texas Constitution, that's an unlawful plan or scheme to leave property off the tax roll just like the Duval County School Board—

THE COURT: All right. Then what's the ultimate effect of it?

MR. GEORGE: It discriminates against my client. It makes it harder for it to compete with its competitors (p. 136) who are sending magazines in here tax free that are not supposed to be tax free, but they decide they're not going to collect it, and that's what Article 8, Section 1 has outlawed, and if the Legislature thinks it's a—if it's a bad idea to have this tax, they ought to repeal it. If it's a good idea to have the tax, they ought to enforce it. The Comptroller, it's our position, doesn't have the authority to decide that it's a bad idea to enforce the—

THE COURT: What you're arguing is—I'm a little ahead of myself, I recognize, Counsel, but it helps me to think through as the evidence comes in—that, one you're not arguing that the tax itself is wrong.

MR. GEORGE: Not if—

THE COURT: It's the way in which it's being enforced?

MR. GEORGE: As applied under Article 1, Section 8—

THE COURT: Right.

MR. GEORGE: If it was enforced uniformly and collected uniformly, as regards Article 8, Section 1 of the Texas Constitution, our argument is it's—

(p. 137) THE COURT: You wouldn't be here, in other words?

MR. GEORGE: I might be here on the religious exemption or something else, but I would not be here claiming an unlawful plan or scheme to collect taxes, and I quite honestly understand that there are—there may be good management reasons to make a decision not to go after trying to collect some taxes. The cases in Texas—there was a good reason not to go after and try to collect money in bank accounts for ad valorem taxes. For years and years that was the statutory—the duty of tax authorities. If they chose not to do that, even though it would cost them a lot of money, it was unlawful, and our argument is this is exactly the same thing. You know, we repealed the tax on bank deposits as an ad valorem—as a—we amended the statute because we decided it was not a good idea.

Here the Comptroller has simply amended the law to the detriment of my client.

THE COURT: All right. Thank you.

QUESTIONS BY MR. GEORGE:

(p. 138) Q. Now, do you—are you aware of magazines from out of state that come into Texas and solicit orders—have people solicit orders for their magazine in Texas?

A. I have received personally things through the mail soliciting purchases of magazines.

Q. Are you aware of door to door salesman (sic) coming through the neighborhood saying they're working their way through school or raising money for the PTA or something and asking you to subscribe to *Reader's Digest* or *Ladies' Home Companion* or some other magazine?

A. I've been fortunate not to have been called on by those people.

Q. Are you aware that they exist?

A. I haven't seen any. Like I say, I personally have not been called on by them. So I really don't know if they are or not.

Q. Okay. Have you been given any list of organizations that are soliciting in Texas—any magazines that have solicitors in Texas and asked by any of your supervisors to go out and try to see if those people are selling magazines to Texas residents?

(p. 139) A. We have followed up on some leads of—more in the lines of book sales in the state.

Q. No magazine sales?

A. Not that I can recall.

Q. Okay. Do you have any knowledge of—well, let me ask it this way: Have you made any effort to try to determine whether or not particular magazines have representatives soliciting orders in Texas?

A. We have not looked at a particular magazine, no, sir.

Q. Okay. Do you audit magazine companies that have some contact with Texas, besides Texas based magazines, from time to time?

A. Yes, sir.

Q. And there is a company subject to a protective order that I'll call—and it's referenced in the protective order that you mentioned in your deposition, and don't say its name. We'll call it the ABC company for the purpose of this question—that you did audit?

A. I would like to go back to my deposition. We talked about two accounts there, one a parent and one a subsidiary. We audited the parent company, and the subsidiary company—(p. 140) I'm not sure whether it was audited, but we reached agreement with them.

Q. Did you audit the company that publishes a series of well-known magazines?

A. Yes.

Q. Did you determine that it did not have any contact with Texas and have to pay the tax?

A. No, that company does have offices here to my knowledge.

Q. You had testified in your deposition that they didn't?

A. I was speaking of the subsidiary company that we were working on.

Q. Okay. Did you make any efforts—have you made any efforts to go to magazines that are circulated in Texas and determine if they have agents out soliciting orders?

A. We have not gone to magazines that—per se. We are currently working with the Multi-State Tax Commission to audit companies that sell into Texas, and they will be—it will be a joint effort on the part of several states for paying some additional money to the multi-state compact. We feel they can represent (p. 141) our interests best in trying to determine nexus issues.

Q. In the 13 years you've been with the company—with the Comptroller there's—*Reader's Digest* sells a lot of magazines. You're aware of that, are yon not?

A. Yes, sir.

Q. Do you subscribe?

A. I'm not sure. I saw one at the house the other day, and I don't know where it came from.

Q. Okay. Was the use tax paid on that?

A. I don't know. I don't know where it came from.

Q. Okay. Did you—have you made any effort to determine whether or not they have solicitors soliciting—

A. Reader's Digest?

Q. Yes.

A. No, sir, I have not.

Q. Have you made any determination as to any company—any magazine company ever to try to find out if they have representatives in the state taking orders for their magazines?

A. I personally have not, no, sir.

(p. 142) Q. Now, you understand that if a company has sufficient contacts with the State of Texas it can be required to collect sales tax from Texas residents, even though it mails the magazine in from out of state?

A. Yes, sir.

Q. Okay, and you understand that it's within the power of the State of Texas to go to these companies and ask them to pay sales tax, if they have sufficient contact with the State of Texas?

A. Yes, sir.

Q. And you have auditors under your control that operate all over the country, do they not?

A. Yes, sir.

Q. You have offices in New York?

A. Yes, sir.

Q. And you could go from your office in New York or send somebody over to the publishing company offices and get their books and records and find out if they have anybody soliciting magazine sales in Texas in person going door to door in Texas?

A. That sounds very good, as you say it— (p. 143) that we have the authority, but if you go into a business located in New York City and they do not have an inventory here or an office here and all they may have is a salesman here and you say I'm from Texas—I'm from the Texas Comptroller's office and I want to see your records, you will probably be back with the Attorney General's office in the State of Texas getting in touch with the Attorney General's office in the State of New York so that that office can demand—they're just not going to throw open their arms and give us all of the records so we can go on a search and seizure look to see whether or not they have a salesman here. This is the reason we've opted to go with the multi-state group who will be auditing for various states and have more access to those records.

Q. But you haven't—in 13 years you haven't done it at all—hard or—I mean, you go out and audit people who are not cooperative all of the time, don't you?

A. This statute hasn't been in effect 13 years, sir.

Q. No. The sales tax?

(p. 144) A. The portion that brought the magazine under—

Q. Yes, sir, and you have audited—other companies have been under the sales tax for a long time, haven't they?

A. Yes, sir.

Q. And you've audited out of state a long time for sales tax compliance?

A. Yes, sir.

Q. For 20 years?

A. That's beyond my time.

Q. For 13 years anyway?

A. Yes, sir.

Q. That's right, and you have gone to companies that have not been cooperative, and you've forced them to comply, haven't you?

A. Yes, sir.

Q. And you have chosen for—to not go to any of these companies and force them to comply who sell magazines in Texas?

A. I think they will—the—if the—magazine companies or other companies in the future will have us knocking on their door through this contract we're working on.

Q. But you think you're going to make (p. 145) some agreement with some other states to do—to go out and audit these companies in the future? Is that what you're—

A. We have done audits of nexus issues in the past. We're opting for future audits in this area to use a different approach.

Q. Have you done it? We've had this tax for over a year.

MR. MENDEZ: Excuse me. Has he done what?

QUESTIONS BY MR. GEORGE:

Q. Gone out and audited a company who sells magazines in Texas to determine if they have salesmen here?

A. Not to my knowledge.

Q. And when do you plan to do it, if you're going to do it—in March, in June?

A. A magazine company, sir?

Q. Yes, sir. In December? When?

A. I don't have that plan, sir.

Q. There isn't any plan, is there?

A. There is a plan that—a contract we're working on with another group to work on nexus issues.

Q. When is this—this is a plan to (p. 146) make an agreement with some other states?

A. It's with the Multi-State Tax Commission, sir. It's a contract. They do audit work for us.

Q. And you're going to hire some people to do this?

A. Yes, sir.

Q. But you don't know when?

A. The contract is in the works right now.

Q. But you don't know when it's going to be done?

A. Not right off, no, sir.

MR. GEORGE: Pass the witness.

MR. MENDEZ: Your Honor, we'll reserve our questions.

MR. GEORGE: We'll call Harry Gerhart.

## HARRY GERHART

was called as a witness and, having been previously duly sworn, testified as follows:

(p. 147) QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. I'm Harry Gerhart, and I live at 1614 Forest Trail in Austin.

Q. And how are you employed?

A. I'm the general manager of *Texas Monthly*.

Q. Can you tell the Court what *Texas Monthly* is—what kind of magazine it publishes?

A. Texas Monthly, Inc. is a company that publishes *Texas Monthly* magazine, which is a general interest consumer magazine that covers the State of Texas for general entertainment and information purposes.

Q. Now, could you tell the Court where *Texas Monthly* magazine is printed?

A. We print the magazine in Nashville, Tennessee.

Q. And can you tell the Court where the subscriptions that come in for *Texas Monthly* are processed and fulfilled?

A. The subscriptions we receive here we send to a company in Des Moines, Iowa that opens the letters and does the data processing to (p. 148) maintain our files, bill people, if we need to bill them, and on a monthly basis, send to our printer the labels that are used to address the magazines.

Q. Okay, and once the magazines are printed in Tennessee, how do they get to your subscribers in Austin, Texas?

A. The subscriber copies that are printed are presorted by postal areas and put on trucks contracted for by the printer, and they're delivered to either Dallas, Houston or Austin for entry into the postal system.

Q. Does Texas Monthly have any contact with these magazines when they leave the printer before they get to the subscriber?

A. No, we don't.

Q. And they're shipped on a common carrier from Nashville to Houston or Dallas or Austin, and then mailed by the post office?

A. That's correct.

Q. Now, can you explain to the Court how or what the relative economic importance of subscription revenue and advertising revenue is to the—to your product?

A. Yes, I can. The economic balance of (p. 149) the magazine is fairly simple, in that we produce material that we hope people will be willing to buy that's either informative or entertaining or a mixture of both and package it with good art and so forth for the purpose of getting them to either buy single copies or to subscribe for subscriptions annual or longer than annual subscriptions. The first and primary purpose is to provide quality material for these people to buy and the second purpose of getting them to buy it is so that we can sell advertising to advertisers who would like to reach those particular people in an effective way in an environment that is—supports or is friendly to their product and who will buy advertising in our magazine because their experience shows that our readers are re-

ceptive to their messages, and their advertising is effective in supporting their sales of their products or services.

The process by which we sell that advertising, which is the bulk of our revenue, is that we publish on an annual basis the number of paid copies we expect to deliver every issue during the year and more importantly, (p. 150) on an average through the year, we'll deliver that many copies. That is a common measure among advertising decision makers as to how effective their dollars are; that is, how many copies or how much are they paying per thousand copies that we're going to put out. We put out 280,000 copies each issue, and the advertisers have grown to be able to trust and expect that we will deliver that number of copies each issue and are willing therefore, to pay the price that we've asked them for that advertising.

We then have the challenge or job of finding on an ongoing basis new readers to replace those, who, because have either moved out of state or we've made them mad which we do periodically, choose to not renew their subscriptions or in some cases cancel their subscriptions. We have to on an ongoing basis every month acquire new subscribers so that we can continue to maintain that 280,000 base level.

Q. Mr. Gerhart, let me ask you of the total—

THE COURT: —sales tax—I mean, your sales across the newsstand?

(p. 151) THE WITNESS: Is included. It's included in that, yes, sir.

QUESTIONS BY MR. GEORGE:

Q. Now, in connection with your total revenue, is it 80/20 or 90/10 of the revenue that comes from advertising?

A. It's close to 80/20.

Q. Okay, and that you guarantee your advertisers that you'll deliver 280,000 paid copies; is that correct?

A. That's correct.

Q. Okay, and you—what percentage of your 280,000 paid copies are sold by subscription?

A. Approximately 83 percent. The other 17 are on the newsstand.

Q. Now, for clarity purposes, the sale on the newsstand of the magazine is—sales taxes are collected and remitted without problem; is that correct?

A. To my knowledge, they're collected by the retailer who makes the sale to the consumer.

Q. And that's the case for all other magazines sold on a newsstand; right?

(p. 152) A. That's correct.

Q. Whether they're published in Texas or anyplace else?

A. That's correct.

Q. The 83 percent of your subscribers or readers who buy through the mail are the focus of what our controversy is about; is that correct?

A. Yes, sir.

Q. All right. Now, in connection with the acquisition of or maintaining 280,000 paying readers, what do you have to do to do that, or how do you go about doing that?

A. Insofar as we're attempting to maintain that level by acquiring new subscribers we have basically four—maybe five ongoing techniques that we use. The first and the most significant one, because it's the one that we can use on an ongoing basis and control or predict performance, is the use of direct mail solicitations where we mail packages. We call them packages. They typically have a number of items together, and they're really just a direct mail cold solicitation asking the person to subscribe to our magazine.

(p. 153) Q. Are you familiar with other magazines that mail into Texas similar solicitations?

A. I am.

Q. Are they mailed in to Texas residents—wherever they're put into the postal service, mailed to Texas residents by national magazines that are not based here?

A. Virtually every magazine in the country does it.

Q. Okay, and do your operations differ in any material way from the way they do it?

A. No material way, except that we mail almost exclusively just to Texas residents and they may mail their national publication to people around the country.

Q. Okay. Now, what are the other ways to get subscribers—mail-order subscribers to your magazine?

A. We will from time to time, run some commercials on television that promote the sale of the magazine and often in that context use a 1-800 number that people can pick up their telephone and call in. We insert in copies that we sell on the newsstand and in copies that (p. 154) we send to current subscribers, what we call bind-in cards. They're cards—little mail—self-mailer cards that are bound in the magazine that we hope people who pick up the magazine and are interested will tear out and mail back to us, and we participate from time to time in the use of agents to acquire subscriptions for us.

Q. Now, what—can you describe the kind of agents you're talking about? Now, these are people who take orders for you?

A. They're in every case people who use their own marketing scheme, and they're varied in different marketing schemes to get consumers to purchase—choose our magazine or anybody else's magazine and purchase those magazines. They receive the order and transfer to our fulfillment company in Des Moines the name and address of the person who has ordered the magazine plus whatever appropriate amount of money we've agreed they will refund to us.

Q. Do any of these magazine agents that you call them that take orders for you have people who go in person in Texas from house to house or from business to business and ask them to give them an order for *Texas Monthly*?

(p. 155) A. One of the ones that we use uses predominantly fund raising projects used typically by schools to—as a way of soliciting orders; that is to say, the end result is that school children, band members, glee club mem-

bers will go block to block, house to house soliciting subscriptions from the residents, and we use those types of agencies periodically.

Q. Now, they take the—an order and send it to Des Moines, Iowa, who then processes it, gets it printed in Tennessee and ships it to the postal service and delivers it to Texas residents?

A. That's fundamentally the process that—the exact sequence of how the school child does what, I'm not familiar with.

Q. For the record, these agents are not buying your product and reselling it, are they?

A. That is correct. They are not.

Q. They are soliciting orders for your product?

A. That's correct.

Q. Now, you've named the direct mail which you said was common, on the basis of what (p. 156) you know for all magazines, national or otherwise, in contacting Texas residents and soliciting subscriptions. Are the other methods you've named—the television, agents, insert orders in the magazine itself—also typical of all magazines?

A. They're all typical of magazines. If there's one that may have—not be universally used, it would be the television. Some magazines simply aren't large enough for that to be a productive technique for them, but all use insert cards that I've ever seen, and as you can know from PCH postage stamp response things, lots and lots use agents.

MR. GEORGE: I'll mark a copy of your product as Exhibit 32—Plaintiff's Exhibit—is it 32?

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 32 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what is marked as Plaintiff's Exhibit 32 and ask you if you can identify that?

A. This is a copy of the February 1986 (p. 157) issue of Texas Monthly.

MR. GEORGE: I'll offer Exhibit 32.

MR. MENDEZ: No objection.

THE COURT: Admitted. Shall I take time to read it now?

MR. GEORGE: Why don't you listen to this, and this evening you can take that exhibit home and enjoy it.

THE WITNESS: Maybe I should identify it as our bum steer issue.

QUESTIONS BY MR. GEORGE:

Q. In connection with the number of subscribers that you have, is there some methodology existent for verifying what you tell your advertisers—that you, in fact, have 280,000 people who subscribe to your magazine or read your magazine?

A. Yes, there is.

Q. And can you tell the Court how that works?

A. Some time back advertising agencies and newspaper and magazine publishers, in an attempt to clarify

who was really doing what they said they would do and who wasn't, formed (p. 158) an organization called the Audit Bureau of Circulation, and it's an industry supported, multi-armed supported audit system. Magazines that choose to tell the truth belong to this organization, and the organization sets forth a set of rules by which you can qualify—have your copies qualify for what is called paid circulation. It specifies how much of your full price must be paid for it to count, and it provides for an assessment of dues so that it can support an audit—a field force that routinely audits all of the members.

Members traditionally submit semi-annually their own report in the format specified by the bureau claiming or stating what their circulation is, and on an annual basis the field auditors of ABC then audit two—or the previous years' two reports. That involves, first, for those magazines that—whose subscription processing or what we call fulfillment is done at the larger major data processing firms, ABC has resident auditors who on an ongoing basis are sampling all of the order processed by that house so that the standard order is verified by a standard (p. 159) sampling system. They then annually come out and verify, with—by looking at our bank deposits and our reports and the checks we wrote that we received money for the newsstand copies that we claimed and tie that, in an audit sense, to the number of copies we say we sold, and they check our printing bills to make sure that we paid somebody to print the number that is necessary to have the number we say, and they check our postage statements to make sure that we paid enough postage to have mailed them, and they issue a report that says, in essence, whether

or not their audit of our statements showed any material discrepancy.

That is done by newspapers and magazines who belong—or done for newspapers and magazines that belong to ABC, and that's the technique that we use. It's the one that's used by most substantive consumer magazines in the country.

Q. Are there—the reports on how much the circulation for *Reader's Digest* and *People* or *Good Housekeeping* or *Cosmopolitan* or any of those magazines available from this source to anybody who wants to look it up?

(p. 160) A. They are. They publish—they reproduce the statements filed by each publisher every six months on what are called pink sheets. They're large, ledger-sized sheets, and those sheets are generally available through ABC to anyone who wants them. Usually most advertising agencies and magazines have a set of their own.

Q. Okay, and if the Comptroller wanted to know what magazines were being circulated or sold to Texas subscribers by *Cosmopolitan* or somebody, they could go to the ABC data base and figure it out; is that correct?

A. They certainly could, yes.

Q. And these's no particular difficulty from that, if they choose to go do that?

A. Not that I would ever be aware of, no. They could come to Texas Monthly, and we could tell them.

Q. In fact, you went to meetings with a Comptroller in the fall of 1984 and tried to explain the livery system of Texas—out of state magazines into Texas, did you not?

A. Yes, we did.

Q. And that they were being sold in Texas by agents who solicited orders in Texas, (p. 161) did you not?

A. We did.

Q. And offered lists of addresses and data for the Comptroller to go out and get these people to collect taxes?

A. We did.

Q. And now focusing on the collection of—putting aside the problem of the consumer who owes a use tax and doesn't pay it—putting that aside and away from this consideration and focusing upon the collection of sales tax only for the purpose of this argument, the—you went to the Comptroller's office and gave them a list of names of publishers—

MR. MENDEZ: Well, Your Honor, if—I'll object because I think it's a leading question. Why don't we just let him answer what he gave the Comptroller's office and—

THE COURT: What's your objection again?

MR. MENDEZ: Leading question.

THE COURT: All right.

QUESTIONS BY MR. GEORGE:

Q. Let me finish the question. Then (p. 162) I'll be happy to rephrase it. Tell the Court what you did in con-

nection with giving the Comptroller a list of names and who they were.

A. I took a list—actually I think we delivered two different times two different size lists, but I took lists of magazines that we believed had sales offices in the State of Texas. That particular list comprised approximately 20 magazines who from our information had advertising sales people—employees who were officed in either Dallas, Houston or Austin. I took that list to the Comptroller's office and asked him to—if he would—could check and see if they had sales tax permits. Of the list of 20, three showed up as having sales tax permits. 17 didn't. I gave them that list, as well as the names of some agents who operate in the state selling subscriptions.

Q. Are these the people who solicit orders for—

A. Yes.

Q. Okay. Including for your company?

A. Yes, that's correct. Secondly, we also provided a list, I believe at a different point in time, of magazines who had substantive (p. 163) circulation in Texas, my definition of that being, I think, in excess of a thousand subscribers. I have frankly forgotten how many there were—an excess maybe of a hundred. Maybe it was 50 or a hundred magazines who were published—whose home offices were listed in ABC records as being out of the State of Texas but who—because of the size of circulation in the state, it was evident that some significant degree of agent acquisition would have taken place on their behalf in the state. Those were the two sets of lists, and I actually took that other one just at his request of who

were people who would—who might be—might have nexus and might ought to be approached for the purpose of collecting sales tax.

Q. Okay, and this is—now, do you have an understanding of whether or not out of state publications do collect taxes from Texas residents that they sell their magazine to?

A. I have no personal knowledge of any publisher who collects sales tax who's out of state, and my understanding is no one tries.

Q. Okay. Now, let me ask you if the collection of sales tax—well, first, before I (p. 164) forget it, I believe the other day somebody came to your house selling magazines door to door?

A. They did.

Q. And taking orders?

A. They did.

Q. Okay, and were they selling a whole bunch of magazines—a national list?

A. A whole raft of them.

Q. All of the major titles—*Reader's Digest, Time, Life,* et cetera, et cetera?

A. Yes, yes.

Q. Okay. Did your family order one?

A. We did mainly to get the guy to leave.

(At this time an instrument was marked as Plaintiff's Exhibit No. 33 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what has been marked Exhibit No. 33 and ask you if that's the order that was—

A. That's our copy of the order, yes.

Q. Okay, and are you familiar with a publication called *Science '85* or *Science* magazine?

(p. 165) A. I am, yes, indeed.

Q. And you're going to get more familiar with it?

A. We hope so, if they ever come.

MR. GEORGE: I'll offer Exhibt No. 33.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, that publication's offices are not in Texas; is that right?

A. That's correct. They are not.

Q. And they have an agent in Texas soliciting orders for them, do they not?

A. They have at least two because two days later another guy came by.

Q. Okay, and did they collect sales tax from you?

A. They did not.

Q. Now, does your company compete in any way with a magazine like *Science* magazine?

A. Very much so.

Q. Can you explain to the Court how that operates?

A. Well, the essence of the magazine (p. 166) business, unlike many other businesses, is that we're all competing for one precious commodity, the reader's time. That's the first and fundamental thing that we're all competing against each other for. All else follows. If we can convince that reader to spend the time to read the magazine, whether it's for information or for entertainment or whatever else, then we have commanded his attention, which allows both the editorial quality of the magazine, that is, the thing we're trying to sell to him, to come through and allows any messages of our advertisers to have some impact on them, too, but in everybody's normal lifetime they choose—they have the time they have to spend doing what they have to do, and they have the time to spend to do what they want to do, and we compete in a broad sense with a lot of different things for that free time, but in a specific sense for whatever reading time that they're willing to commit, we're in competition with virtually all other magazines, and in a specific sense some people will have a special interest, such as tennis, and they'll make some commitment of time specially to that interest, and then that means (p. 167) we're competing with all of the other general magazines for the remaining reading time that they have. So in a very real sense, we compete with all magazines or all general interests and non-mandatory reading.

Q. All right. Now, does the payment of the tax by your company and the non-payment of the tax by *Science '85* or *Reader's Digest* affect yuor company in any way?

A. It has a very fundamental effect in the long run.

Q. Will you explain that to the Court?

A. Not just to our magazine but ultimately to the readers themselves. The nature of our business is that we're unable to collect this tax from anybody else; therefore, this tax becomes an expense to our company and in our case a fairly significant expense in just a very direct sense. Now, to the extent that other companies who are competing for time don't have a similar expense—and for instance, in *Science '85*'s case that's very much the case. It simply means that over time they have that much more resource to devote in a competitive sense to the quality of their magazine than we (p. 168) do, and since it is the quality of the magazine that in the end makes this whole system work—makes it an appealing product for the reader to read the first time and to continue to read because he enjoys it, in the end our economics fundamentally are materially impacted by that disadvantage, and the reader is impacted in that the reading material in the end isn't what it could be, if we didn't have that disadvantage.

THE COURT: What are you saying? You mean with the money that you saved you could hire a writer that might end up being more—

THE WITNESS: That's an exact recent occurrence or put more color in it.

QUESTIONS BY MR. GEORGE:

Q. Let me ask you, in connection with this *Science* subscription, by the way, to tell the Court the relationship between that first order in the magazine industry and the renewal of that industry—how that would work for your company?

A. One of the phenomena, as I said earlier, that we're trying to do is we're trying to convince a new reader to try us under the (p. 169) belief that they'll enjoy us, and the marketing hurdle that we have inducing that first purchase is very significant compared to the hurdle that we have after a person has taken us for a year to continue to take us. We, in fact, have a good renewal rate—a very good renewal rate.

The economics are that we spend--gosh, I can't even tell you how much, but multiples in terms of promotional expense to secure the first reader compared to the amount of money that we spend to induce a current subscriber to renew, and in fact, after someone has read us for two years, we have to spend almost no money at all to--we just have to essentially offer them the opportunity to renew their subscription again and they do, the net result being that from the—from a profit and loss standpoint, it's in the third year of a person's subscribing to *Texas Monthly* that we finally make—begin to make money enough to help pay for the printing of that magazine itself. The first two years—

Q. Off the subscription itself?

A. Off the subscription itself.

Q. Could you tell the Court what the—(p. 170) from the companies you deal with, the ratio of the Commission is paid for those order solicitors generally that come door to door for your company?

A. Agents—field agents typically remit or send on to the publisher between eight and 12 percent of the purchase price.

Q. 90 percent is paid as commission?

A. 90 percent is retained by them as commission.

MR. MENDEZ: Before he goes on, I'm not sure to object or not. Did you mean that that was Texas Monthly's experience—that's what they remit to these agents for soliciting? Is that your testimony?

THE WITNESS: That's what we remit—it's my testimony that we remit in that range and that other magazines as well—

MR. MENDEZ: I'll object to that question to the extent that it calls for his opinion of what other magazines that he hasn't been called for—on or shown any experience on—that he's relating it—

THE COURT: All right. I'll sustain it at this point.

(p. 171) MR. MENDEZ: Thank you.

QUESTIONS BY MR. GEORGE:

Q. Now, in connection with your company, Mr. Gerhart, is the willingness of your company to pay 90 percent commission for that first order related in any way to the opportunity to get renewals?

A. Well, it's related entirely—I mean, our willingness to pay anything for any—because we pay, one way or the other, for all first time subscribers—is clearly for an opportunity to renew that reader and to renew them again after that, if we can.

Q. And so that person coming door to door is kind of a get the foot in the door system; is that right?

A. Absolutely, yes.

Q. Okay. Now, can you—

THE COURT: Let me ask you this: Sometimes when they come door to door, they are not only—well, I would tell them I already subscribe to that. "Well, but you can renew it through us." Does the renewal work the same way?

THE WITNESS: Well, it (p. 172) works—from your viewpoint, it works the same way, in that they'll process that order, and when your current order would otherwise end, it would continue. From the publisher's standpoint, it doesn't work the same way, in that he gets ten percent of what he woul have gotten otherwise, but there's nothing he can do about it. He's certainly not going to tell you, "Sorry."

QUESTIONS BY MR. GEORGE:

Q. Now, can you explain to the Court now—what Texas Monthly does to remit the sales tax that's paid under protest?

A. Yes, sir. We send—first, I'll start off by saying that we send all of our mail orders and payments. We receive them in Austin. We count them for the purpose of having a volume count. We box them up, and we send

them the same day to the fulfillment house in Des Moine, Iowa. They cashier the material; that is, they make proper records—a receipt of all of the money, and then they deposit it in a bank account of ours in a bank in Des Moine, and we the following day, transfer that money back to our —here in Texas to our account. At the end of the month, for the month in question, our (p. 173) accounting staff takes the cash receipts in that bank account, and that bank account is notated the deposits which were for subscriptions and what small amount could be for any other item and using—uses that report of money received to calculate the amount of taxable sales that we report on our monthly sales and use tax report. Do you want me to explain the rest of that computation?

Q. Yeah, how do you compute the amount to send in?

A. Okay. The issue—well, first, we begin with an amount of money—gross amount of money deposited in the account. We take the distribution of subscription copies mailed during that same month, and we get quantities mailed by zip code from our computer system so that we can know exactly what the fractional percent that were mailed into the State of Texas are. We apply that percentage for that month to those deposits and the—to determine what we consider to be the in-state sales for that month. That amount of money is then added to the—well, for the line that says gross sales, is added to the amount of receipts that we received (p. 174) for newsstand sales. While they're not taxable, they're reported on that line, as well as the amount of money that we received in our office that month where individuals walked in and asked for copies of, you know, the December issue

or something like that. All other taxable sales, in other words, that we have—that sum is reported as gross revenue. Then the next line, gross taxable sales, is that amount backing out the newsstand receipts because they're not taxable, and the next line in the form—

Q. Not taxable in the sense that the retailer collects the tax?

A. That's correct.

Q. Collects the tax?

A. That's correct. They're exempt because they were sold for resale. We then compute the use—the value of the—of items that are subject to use tax. The taxable sales plus the use tax quantity is added up, and we pay six and an eighth percent of that to the Comptroller.

Q. Okay. Now, do you—are you aware that there are varying tax rates in this state depending on where you live?

(p. 175) A. Very much.

Q. Okay, and as I take it, your magazine is shipped out of Nashville, Tennessee?

A. That's correct.

Q. By a common carrier, then the post office to people in Texas; is that correct?

A. That's correct.

Q. And do you have any way to determine what—or collect or remit the tax for the person who lives at Buda

and is not in the MTA but the person who lives in West Austin who is and owes both the MTA and the other tax? Do you have a system for doing that?

A. We don't, no.

Q. Is there a way you could do that?

A. Well, it could be done hypothetically, if we were able to get our fulfillment house—the computer company that keeps track of our readers to modify their system. Your Honor, we keep track of every individual reader and each of his subscriptions so that we can tell when it should start and when it should stop, what he paid for it, whether he paid for it in cash or whether we have to bill him, and those are called trailers, (p. 176) and we keep them on a massive computer—or this company does. So all of that information is kept on a discreet basis, with the result that if you were to cancel that subscription that you were talking about you would get back the remaining portion of what you'd paid them—not what you'd paid on the previous one, for instance. We get—all of that information is discreet. Now, that computer system at our fulfillment house and at all of the others in the nation currently don't have the capacity to handle sales tax, but were they to and were the comptroller to be able to provide us with, on an updated basis, the current tax rates by zip code, then hypothetically we could pay the tax based on what the weighted average was.

Q. Is there any way to do it now?

A. No.

MR. MENDEZ: I think I want to object again, Your Honor, but I'm not sure what he was testifying to halfway

through that question. Did you say that you had knowledge about the way that other computer systems are set up for other types of magazines that are sold throughout the United States?

(p. 177) THE WITNESS: I did.

MR. MENDEZ: Okay, I'll move to strike that portion. I'll object to that as being hearsay. He hasn't shown any testimony here as to knowing what those computer systems are set up to do or not to do.

THE COURT: He just said he did. Now, if you want to take him on voir dire to find out—

MR. MENDEZ: Sure.

THE COURT: —where that comes from, I'll permit you to.

MR. MENDEZ:: Thank you, Your Honor. May I?

THE COURT: Sure.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Gerhart, which corporations, other than your fulfillment house, maintain computer programs that account for subscription receipts?

A. The other one that I'm familiar with is Neodata in Boulder, Colorado.

Q. How do you spell that again?

(p. 178) A. N-e-o-d-a-t-a.

Q. Okay, and do you have a contract with that corporation?

A. Not at the present time.

Q. Okay. Have you ever had a contract?

A. We have.

Q. Okay. When was that?

A. From the inception of the magazine until approximately two years ago.

Q. Okay, and in the course—were you the general manager during this period of time?

A. I was.

Q. Okay, and in the course of your negotiations with them, did they explain to you how they accounted for taxes?

A. They did.

Q. Okay, and do you know if they still maintain that program at this date?

A. They never accounted for taxes at that time.

Q. Do you know if the program that they're using at Neodata today is identical to the one that is being used by your fulfillment house in Iowa?

A. It is not identical.

(p. 179) Q. Okay, and can you identify for us what the name of the computer is or the program is that accounts for these subscription sales by Neodata?

A. Well, I know the hardware is IBM. I have no idea—in fact, they write their own software.

Q. Okay. Who's the computer software writer?

A. Well, the head of the department, I believe, is a gentleman named Gary Smith.

Q. Okay, and when did you last communicate with Mr. Smith?

A. I guess about a year ago.

Q. Okay, and did you ask him about how they accounted for taxes on their system at this time?

A. I did not.

Q. Okay, and have you had an occasion to contact that corporation in the last year since this lawsuit has been going on?

A. No, I haven't.

Q. And could they have changed their computer program to use some different program in the interim?

(p. 180) A. Not without me knowing about it.

MR. MENDEZ:: Okay. I withdraw my objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. By the way, Mr. Gerhart, are you—were you aware, when you were dealing with Neodata, the companies it did business with besides your company, in terms of magazines, or some of them?

A. Some of them, certainly.

Q. Can you name them?

A. Well, *Bon Appetit, Architectural Digest.* Frankly, Mr. George, there are so many of them I'd run a real danger of being wrong.

Q. What about the fulfillment house in Iowa? What's the name of that one, by the way, that you're using now?

A. It's CDS, which I believe stands for Communications Data Specialist.

Q. Okay, and do they fulfill the subscriptions of other magazines like they do yours?

A. A number of them, yes.

(p. 181) Q. During the course of your work at Texas Monthly, have you had an opportunity to investigate other companies that provide national fulfillment services for magazines?

A. Not in depth in the sense that we did CDS but have been investigating them enough to be familiar with who their clients were and what their cost structures were.

Q. Okay, and in the course of that work, have you learned that most, if not all, national magazines are circulated through fulfillment houses just like you are?

A. That's correct, we have.

Q. And is that the case?

A. It is the case.

Q. By the way, where is *Playboy* circulated through? Is it through Neodata or CDS?

A. Well, it was at Neodata and I don't know—I think it's there because one time they sent our billing series to all of the latest *Playboy* people.

Q. I remember that.

A. Yes, I thought you might.

Q. I thought you might know about that (p. 182) one. Now, in connection with the—your work, have you made an effort to try to have purchases made of magazines that are religious in nature—

A. I did.

Q. —that are published in Texas?

A. Yes, sir.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 34 and 35 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what is Exhibits Nos. 34 and 35 and ask you if you can identify them?

A. These are two publications that my staff, at my direction, purchased, one by subscription and I believe the other one just—actually I think she subscribed to both of them.

Q. Were there sales taxes charged on any of those subscriptions?

A. Neither.

Q. And they're both published in Texas?

A. That's correct.

MR. GEORGE: I'll offer Exhibits Nos. 34, *Grassroots*, a publication of the Episcopal Churches of Texas,

and a book called *Journal of Church* and *State* published by (p. 183) Baylor University, I believe, the J. M. Dawson Institute of Church and State Studies at Baylor University.

MR. MENDEZ: Well, we've never seen those publications before, but I guess we have no objection. I think they fit the hearsay rule anyway.

THE COURT: No objection?

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, let me ask you, Mr. Gerhart, in connection with the collection of sales tax, what—can you explain to the Court what problems that presents for Texas Monthly when you ask someone to pay the sales tax and they don't pay it for a subscription—or subscriber?

A. Well, if we ask them to pay it and they don't, the problem is that we simply have to pay it for them.

Q. Why don't you just withhold the magazine and not send it to them unless they send you the six percent sales tax?

A. Well, this goes back to the model (p. 184) that we subscribed earlier. Our obligation to run the magazine and to fulfill the guarantees that we have sold to advertisers some months before for any given issue is to acquire and have paid subscribers for each issue so that we can be sure that we send 280,000 copies, and the issue of whether someone has paid or not paid the sales tax doesn't affect

the paidness of the copy. So that subsequently if we have a person who chooses to send in their money but chooses to not pay the sales tax, one, it's not economically efficient to bill them for the 62 cents. It costs us 6 or $8 by the time we generate the bill, stuff it in an envelope and pay the postage and so forth. So we don't do that, but we certainly don't not (sic) send them their copy. Otherwise we would not have any certainty, in terms or our ability to meet our guarantee on our advertising. That's a different issue, Mr. George, than the one of why don't we ask them to pay it to begin with, but that's just—I just point that out. This is—

Q. Well, I was going to ask you if you've asked them to do that, and we have Mr. Childs' circulation—

(p. 185) A. Right. Okay.

Q. That's the test, and we'll put on that for—

A. Okay.

Q. But I'm dealing with the general problem of nonresponsiveness of subscription consumers to the demand to pay the tax and what—why that won't work from economics and that sort. Let me ask you what percentage of your magazine subscriptions are sold on credit instead of they send the money in in advance?

A. I would guess 50 percent. It may be less than that. I know that our major direct mail offer solicits cash with their order, and there is a very high response as a result of that, and it made—Mr. Childs would know that figure more closely, but it may be as low as 30 percent as for credit payments.

MR. GEORGE: Okay. I'll pass the witness.

THE COURT: We'll take a recess at this time. We'll recess for 15 minutes.

(At this time a brief recess was taken, during which time an (p. 186) instrument was marked as Defendants' Exhibit No. 1 for identification, after which time the proceedings continued as follows:)

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. I have a few questions on cross examination. Mr. Gerhart, I've had an exhibit marked in the interim here as Defendants' Exhibit No. 1. Could you identify this document for us, please?

A. This is an ABC Publisher's Statement for the period—six-month period ending December 31st, 1984 for Texas Monthly.

Q. Okay, sir, and is that the pink sheet that you were referring to earlier during testimony?

A. It is.

Q. Okay, and you have these types of sheets for other magazines that are in circulation in Texas?

A. Yes, sir.

Q. Okay, and it was your testimony that these could be used or made available to the Comptroller's office, if they so desired; is (p. 187) that correct?

A. It is.

Q. Okay. Could you point to the Court where on that document the Comptroller might determine or one of his

employees might determine what locations a—one of these magazines that has a pink sheet has in the State of Texas?

A. I will. Your Honor, the report is—shows average circulation and sources of acquisition for a six-month period, but the publisher picks one issue during that six-month period, and he reports the distribution by state for both single copy or subscription sales and newsstand sales. So that one can look at a state—for instance, in this case for that issue of ours we had 211,436 copies of subscriptions came here out of the total of 242,000 subscriptions, and we had virtually all our newsstand. So that you could look at this same kind of distribution on any ABC statement and get for that one issue what the distribution was in the state, and one would have to make some assumptions about the stability of the circulation of the magazine and project that to (p. 188) the total distribution.

Q. Well, let me ask you a few questions about that. Isn't it true that all of that back page of that pink sheet has is how many magazines were circulated into a particular state? Is that what it says on there?

A. For that given issue, yes, sir.

Q. Okay. Does it—and what I'm asking you is does it say anywhere on that pink sheet that that particular magazine has a location in the State of Texas or some other distribution point in the State of Texas, and that's what I'm asking you?

A. This one does, yes.

Q. Okay, because that's *Texas Monthly*'s?

A. That's correct.

Q. Okay, but what I'm asking you is does every one of those pink sheets—let's say, one from some hypothetical out of state—

THE COURT: Well, use the *Reader's Digest.*

QUESTIONS BY MR. MENDEZ:

Q. —*Reader's Digest*—would *Reader's Digest's* pink sheet indicate that it had a location in the State of Texas on that document?

(p. 189) A. Not necessarily.

Q. Okay, and is there a standardized place on that document where it would show its warehouse or its office or its advertising office in the State of Texas?

A. No, there's not.

Q. Okay, sir. Now, you have mentioned that *Texas Monthly* is located in Austin. Does *Texas Monthly* have any facilities or locations in other cities in the State of Texas?

A. It does.

Q. Okay. Could you tell the Court where those locations are?

A. We have an advertising editorial office in Dallas, Texas and in Houston, Texas.

Q. Does *Texas Monthly* have any other locations in Texas at all?

A. No, it does not.

Q. Okay. Does *Texas Monthly* have any salesmen that might travel to other locations in Texas?

A. Yes, we do.

Q. Specific cities?

A. We have a sales force in Austin, Dallas and Houston, and salespersons from any of (p. 190) those three could on any occasion travel anywhere in the state.

Q. Okay, sir, and now, I want to ask you a question about is it *Texas Monthly's* business decision—or is it your testimony that it's *Texas Monthly's* business decision to operate through a fulfillment house?

A. Yes, it is.

Q. Okay. In theory at least, couldn't you set up a subscription department here in your own headquarters and sell your subscriptions through that? I mean, in theory is what I'm asking.

A. You mean realistic theory? No, we couldn't.

Q. Okay. You could not sell your subscriptions in any other way?

A. Well, for the computer systems it would take to run an adequate size to do what we would have to have done given our size, it simply wouldn't be feasible for us to own ourselves.

Q. Okay, sir, so what you're saying is that it's your business decision to operate through a fulfillment house because it makes it (p. 191) cost effective for you to sell your magazine on a volume basis?

A. That's correct.

Q. Okay, sir. Now, is it *Texas Monthly's* business decision to sell by subscription at all?

A. Yes.

Q. Okay, and you could sell the magazine just over the counter, if you wanted to; is that correct?

A. You mean only over the counter?

Q. Only over the counter.

A. We could sell some copies over the counter, yes.

Q. Okay, but you made a conscious—*Texas Monthly* made a conscious decision on a business like basis to try to address a larger market, and that was through a subscription approach; is that correct?

A. Yes, it is correct.

Q. Now, I want to understand how you decided to apply the tax rate at six and an eighth to your total volume of taxable sales. Is that a decision that you made or that someone in the management of *Texas Monthly* made?

(p. 192) A. Yes, it is.

Q. Okay, and is it Texas Monthly's business decision to send out issues of its magazine without—to subscribers without insisting that they remit the use tax first?

A. Yes.

Q. What I'm asking you is did you make a conscious decision to enter into subscription contracts with persons and then start honoring those contracts without asking them, "Send me the Texas use tax first"?

A. Yes.

Q. Okay, sir. Now, I'm going to hand you the tax code, and it's Article—I mean, Section 151.103, and I'm going to have you read 151.103—the first section of that to the Court.

A. "151.103. Collection by retailer, purchaser's receipt. A retailer engaged in business in the state who makes a sale of a taxable item for storage, use or consumption in this state shall collect the use tax that is due from the publisher and give the purchaser a receipt for the tax payment."

Q. Okay, sir, and I'm going to ask you (p. 193) now did Texas Monthly collect a tax from the users and give them a receipt for that tax?

A. No.

Q. Okay, and why didn't it do it?

A. Well, we didn't give them a receipt because we didn't collect the tax.

Q. Okay, and why didn't—doesn't that statute say shall collect a tax in there?

A. Yes, it does.

Q. Okay, and I'm asking you that's a Legislative enactment, and I'm asking you—well, do you-all have a sales tax and use tax permit?

A. We do.

Q. Okay, and you're a retailer, do you understand, under that statute?

A. I guess so.

Q. Okay, and I'm asking you did you make a conscious decision not to collect a tax, as it says to do it in that statute?

A. We did.

Q. Okay, and what was the basis for making that decision?

A. Because the cost to us—economic cost to us, if we attempted to collect the sales (p. 194) tax and whether we gave a receipt or not, was so high that our decision was—so we could stay in business—that we wouldn't attempt to do that.

Q. Okay. That's a business like decision, don't you think? I mean, isn't that the reason you did that?

A. That's correct.

Q. Okay. You don't have a moral obligation not to collect use taxes or some other conscience that says, "well, I'm not going to impose a use tax on these people." You just did it because it was a business decision; is that correct?

A. Well, we have an obligation to pay the tax to the State—

Q. But you figured—

A. —and we do that.

Q. Okay, and your testimony is that you figured that by backing into it through your gross sales and the amounts of copies delivered to Texas citizens; is that correct?

A. That's correct.

Q. Okay, but you didn't follow the letter of that statute, did you?

(p. 195) A. We did not.

Q. And you couldn't follow the letter of that statute in carrying out your statutory duties and stay in business; is that correct?

A. That's correct.

MR. MENDEZ: We'll pass the witness.

## REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Gerhart, you mentioned a sales force in some of these cities. Do these people sell subscriptions or sell advertising?

A. They sell advertising.

Q. Okay, and in terms of making advertising sales, that's to solicit Neiman-Marcus or other people to run ads in your magazine; is that right?

A. That's correct.

Q. Now, in connection with subscription sales force, you don't have your own employees that are—that sell consumers the magazine, do they—do you?

A. We—not directly on a personal basis. We have staff in the office who (p. 196) coordinate the construction and use of the other techniques I have described earlier.

Q. You have a circulation director that's—

A. And a department that works under him that does try and procure subscribers.

Q. Do you have door to door salesmen or other sales force that sell the readers like me or Mr. Mendez subscription sales?

A. No, we do not.

Q. And in connection with your subscription sales efforts in Texas, they're carried on not by sales force located in three cities but in the manner we talked about before?

A. That's correct.

MR. MENDEZ: Before—I don't have any more questions, but before he steps down, I'd like to offer Defendants' Exhibit No. 1 into evidence.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. MENDEZ: Thank you.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No further (p. 197) questions.

MR. GEORGE: We'll call Steve Childs.

## STEPHEN A. CHILDS

was called as a witness and, having been previously duly sworn, testified as follows:

## DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. My name is Stephen A. Childs, and my address is 1706 West 30th Street.

Q. Austin, Texas?

A. Austin, Texas.

Q. Okay. How are you employed?

A. I am the circulation director at *Texas Monthly.*

Q. Okay, and what are your duties as circulation director at *Texas Monthly?*

A. My duties are to maintain our rate base and to—

Q. What's a rate base?

A. A rate base is the guaranteed (p. 198) circulation that we give to advertisers—that we promise to advertisers, and it is the circulation on which our advertising rates are based.

Q. Okay, and how many copies of the magazine are in your rate base now today?

A. 280,000.

Q. Okay, and does the rate base change from time to time?

A. It can.

Q. Okay. Now, is there a need for the magazine—for *Texas Monthly* magazine to solicit new subscribers?

A. Yes.

Q. And can you tell the Court how you go about soliciting such subscribers?

A. Well, we have a variety of channels of sale. We solicit subscribers primarily through direct mail. We also use agencies—subscription agencies.

Q. Let me stop you and ask you to tell the Court—explain to the Court how the direct mail solicitations work.

A. All right. It may be easier if I used the board over there. May I do that?

(p. 199) THE COURT: Sure.

THE WITNESS: A direct mail campaign is done by first renting a group of lists. These lists may be magazine lists or compiled lists. They're primarily magazine lists that share similar demographics.

QUESTIONS BY MR. GEORGE:

Q. Lists of what?

A. Lists of names and addresses of other subscribers, if they're magazine lists, but they're lists of names that share similar demographics to our magazine.

Q. And what do your magazine—what are your magazine demographics? By that, do you mean the characteristics of your subscribers?

A. Yes, it's the—

THE COURT: Education level?

THE WITNESS: Education level, the income level, the median age and so on.

QUESTIONS BY MR. GEORGE:

Q. And by the way, what do you think are the demographics of *Texas Monthly* subscribers?

(p. 200) A. Well, the median age is approximately 40. The income level is in the 40,000 range. The education level is overwhelmingly college-educated, postgraduate work, married, 50 percent male, 50 percent female. Those are the primary characteristics.

Q. Do they live predominantly in Texas?

A. Yes, 90 percent of them live in Texas.

THE COURT: Or former Texans?

THE WITNESS: Right.

QUESTIONS BY MR. GEORGE:

Q. Okay, and I'm sorry. I interrupted you. What you do—you rent the lists from people that have lists of names?

A. Yes, we first get the lists. The second thing we do is we use a computer service to perform what we call a merged purge.

Q. Are those—that computer and your people at the fulfillment house in Iowa that does that for you?

A. Yes, in our case our fulfillment house is also doing our—

THE COURT: What's a (p. 201) merged purge?

THE WITNESS: The merged purge is where we take all of these lists, and they feed them into a computer system, and they literally merge the names together so that they can identify, first of all, who are already sub-

scribers to our magazine. They kick those out. Secondly, they purge out all of the duplicates. The name may appear on more than one list. So we keep it once and then purge out all of the duplicate names.

After doing this we arrive at our net names, and from these names they generate labels, which are then applied to our direct mail pieces.

So the third element of a direct mail campaign is the package, and on the package, these labels will be applied, and we tend to use the same package. Once we know it works, we use this package over and over. It's called our control package, and from time to time we will do tests against this package. A test is primarily a version or a different package that we test against this package using the same body of names, and we randomly select (p. 202) across this list so that we get statistically valid groupings of names for the tests, as well as for the control package. The names—the characteristics of the names are indistinguishable between each other.

QUESTIONS BY MR. GEORGE:

Q. Now, you run these tests, I take it, to see whether a price of $12 for 14 issues is better than $10 for 12 issues and that you get more buyers at different kinds of prices, as a hypothetical example?

A. Yes.

Q. Or you might add other characteristics to your offer or six-month subscriptions versus two years or some other characteristics?

A. That's right. The overall purpose of these tests is to find some element that will ultimately increase our response rates.

Q. Okay, and do you use these tests on a regular basis?

A. Yes, we do.

Q. Once a year or more frequently than that?

A. Usually we're testing something in (p. 203) every direct mail campaign, and we mail about four times a year.

Q. Okay. All right. Now, you were telling the Court what you did to maintain your rate base or to build up circulation. Why don't you tell the Court what you—you can sit back down, if you want to.

A. I'm sorry. Could you repeat the question?

Q. You were telling the Court the other things you do besides the direct mail campaigns to maintain your rate base or the number of subscribers and users of *Texas Monthly*. What else besides direct mail?

A. Besides direct mail we have insert cards, which are bound into copies of the magazine. There may be one in that copy right there, and those go into both our newsstand and subscriber copies.

A third method of obtaining subscriptions is through subscription agencies. Those are primarily, in our case, direct mail agencies and school agents, direct mail agents being an agency that sends out—Publishers Clearinghouse is an example. They (p. 204) send out stamp sheets and people choose the number of magazines they want. They

send it back to the direct mail agent. The direct mail agent then forwards those orders to the individual publishers, and they take the majority of the subscription price as their commission. School agents enter into arrangements with schools so that the schools have school children that go around to the neighborhoods and basically take orders for a variety of magazines on an individual publisher's behalf.

Q. Now, let me ask you for those school agents, at least, those are—are those in Texas or other places?

A. They're all over the country, but for us we use them in Texas.

Q. Obviously you need subscribers in Texas?

A. In Texas, right.

Q. Okay, and so the school agents you hire deliver your—solicit orders for you in Texas?

A. That's correct.

Q. Okay, and are there any other (p. 205) methods besides direct mail, insert cards and the agents that you use that you maintain your—

A. Those are the primary three.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 36 through 39 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I hand you what has been marked Plaintiff's Exhibits Nos. 36 and 37. Can you identify those for the Court, please?

A. Yes, I can. This is the school plan booklet for *TV Guide,* TV Guide School Plan.

Q. Now, tell the Court is that one of these people who have children or others go around and solicit subscriptions for you?

A. Yes, it is. We are in this particular booklet, and this booklet identifies all of the magazines that this particular school plan offers through their schools that they enter into arrangements with.

Q. And those are used in Texas; is that correct?

A. Yes, that's correct.

Q. To solicit subscribers for you among others?

(p. 206) A. Yes.

MR. GEORGE: I'll offer Exhibit No. 36.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Would you tell the Court some of the magazines that solicit subscriptions through *TV Guide's* plan that are in that book?

A. Well, virtually every magazine in the country is in here but *American Film, The American West, Dallas Magazine, Denver Magazine, Ellery Queen's Mystery Magazine.* I'm sure if I go over here, we'll find some of the better known names. There's *Popular Bridge,* and then we have *Texas Monthly, Texas Fisherman, Texas Business.*

Q. How about *Reader's Digest?*

A. *Reader's Digest* is probably in here. Let me just find it. No, *Reader's Digest* is not listed in this particular one.

Q. Okay. Is *Playboy* listed?

A. *Playboy?* There are three different sections of this booklet. That's why I'm checking the alphabetical listing under each. I (p. 207) don't see *Playboy* in this particular one, but I have seen it in the past.

Q. What is Exhibit No. 37?

A. Exhibit No. 37 is the authorization agreement that I enter into with *TV Guide's* school plan.

Q. I notice that the company is Mediatex Communications Corporation. Can you identify for the Court who that is?

A. Mediatex Communications Corporation is the parent company that owns Texas Monthly, Inc.

MR. GEORGE: I'll offer Exhibit 37.

MR. MENDEZ: Before I object to it or not object to it, is that authorization strictly for *Texas Monthly* magazine subscription sales?

THE WITNESS: Yes, it is.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. I'll show you what's been marked as Exhibit No. 38, which is an envelope and 38A and B and 39 and ask you if you can identify those?

(p. 208) A. Exhibit No. 38A is the booklet that *Reader's Digest* company uses. I believe this is their QSP subsidiary. That's Quality School Plan, and in this particular booklet they're offering *Money* magazine, *Golf* magazine, *Golf Digest, Discover, Sports Illustrated, Los Angeles* magazine, *Texas Monthly, Time Magazine,* and virtually any that you could name.

Q. How about *Reader's Digest* in that one? Let's try *Reader's Digest* in that one.

A. Let's see. Yes, there is *Reader's Digest* at one price, *Reader's Digest-French Edition, Reader's Digest-Spanish Edition.* That about covers *Reader's Digest.*

Q. Okay, and those again—is that a company you have a contract with?

A. This particular company, yes.

Q. And is the Exhibit 39 a copy of that contract?

A. Yes, this is our authorization agreement.

Q. Okay, and those—is the catalog that is Exhibit 38 the catalog used to sell your magazine along with the other magazines by school agents in Texas?

(p. 209) A. Yes, it is.

Q. Okay, and to solicit subscriptions for you along with subscriptions for *Reader's Digest* and *Golf* and *Skiing* and all of those other magazines?

A. That's correct.

Q. Okay. What about the rest of Exhibit 38?

A. This appears to be the order form that the school children use when they go up to someone's house and ask

them what magazines they want to subscribe to, and they fill out all of the names and addresses on here. These are then sent back to the school agent who then processes them and sends the orders to the publishers.

Q. Okay, and that's part of the package used for your magazine solicitations through that company?

A. Yes, it is.

MR. GEORGE: Okay. I'll offer Exhibit 39, and did you identify them?

QUESTIONS BY MR. GEORGE:

Q. Exhibit 39 is the contract?

A. That's right.

MR. GEORGE: I offer (p. 210) Exhibit 39.

MR. MENDEZ: No objection to 39.

THE COURT: Admitted.

MR. GEORGE: And 38A and 38B along with 38, which is the cover of those two exhibits.

MR. MENDEZ: I'll object to those, unless I can take him on voir dire. I want to understand how he knows what these things are used for.

THE COURT: All right.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, you indicated, in looking at the form that's included in that, that that is used as an order form. Have you ever seen these before today?

A. Yes, I have.

Q. Okay. Where have you seen them?

A. I have seen them in my office. These are sent to me regularly from the various school agents, and they keep us up to date on exactly what materials they're using in their (p. 211) solicitations. Seeing as how they're making money off of us, they want us to be apprised of what their activities are.

Q. Okay. So your testimony is that you're familiar with those types of order forms such as Exhibit 38B and that that's the form that is used to take the order for your magazine; is that correct?

A. Yes.

MR. MENDEZ: Okay. I withdraw my objection.

THE COURT: Admitted.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. Now, Mr. Childs, can you tell the Court whether or not your company has conducted any of the tests that you've described for the Court to determine the affect of a sales tax on your effort to maintain your rate base or in getting subscribers to *Texas Monthly??*

A. Yes, we have.

Q. Okay. Would you explain to the Court what you did?

A. We conducted a test, as I described (p. 212) it over there on the board, where we tested two panels of

5,000 names each. One of the panels had on the order card, which was the control panel—had no mention of sales tax. It simply had our control offer, which is 12 issues for $12 or 14 issues for $12 with payment, and then on the test panel—on the test order card we had an asterisk after the price. We said 12 issues for $12.62 asterisk, and that was a footnote at the bottom of the order card saying plus 62—or include 62 cents sales tax, I believe is what it says. The net result of this test was that 17.3 percent fewer subscribers responded to the panel that mentioned sales tax versus the panel that did not.

Q. What's the affect on *Texas Monthly* of a—such a reduction in a response? Is that a big reduction or a small reduction?

A. It would be disastrous. It would significantly reduce our ability to acquire subscriptions, thereby reducing our circulation, thereby reducing our rate base, which would hurt our advertising rates, and the economic effect would be far beyond a simple subscription—the simple subscription price of $12.

(p. 213) (At this time instruments were marked as Plaintiff's Exhibits Nos. 40 through 42 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Mr. Childs, while Mr. Mendez examines those exhibits, let me ask you in conducting this test was there any difference between the list of names of people who were mailed the package containing the reference to sales tax and the people who weren't?

A. No, there was no difference whatsoever. Because of the method that we select the names, it renders

both panels indistinguishable in characteristics. The names and addresses on each panel are demographically and characteristically identical. They're not the same names and addresses on each panel, but the way they're selected statistically they're identical.

Q. Was the tests that you ran to test the effect of the sales tax on your publication and the attempt to collect it run in the same manner you run the tests that you run as a routine part of your business every—four times a year when you send out mailings?

(p. 214) A. Yes, it was.

Q. I'll hand you what have been marked Exhibits Nos. 40, 41 and 42 and ask you if you can identify those, please?

A. Exhibit No. 40 is the order card that shows the sales tax. Do you want me to read these or—

Q. No, not necessarily.

A. —just identify them? Exhibit No. 41 is our control order card. This is the order card we use all of the time.

Q. Is there any difference between 40 and 41, except the reference to the tax?

A. No, there is a line on one that is insignificant, as far as response.

Q. Okay, and what is Exhibit No. 42?

A. Exhibit No. 42 is a summary of the results between these two panels, which ultimately shows that the test panel had a 17.3 percent reduction in response over the control.

MR. GEORGE: I offer Exhibits 40, 41 and 42.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Pass the (p. 215) witness.

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, you mentioned that you—

MR. MENDEZ: If Your Honor might—if you could hand him those so that I could ask him a few questions?

THE COURT: Which ones do you want?

MR. MENDEZ: These tests and these panels here.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, when did you conduct this study again? When did you mail them out?

A. These were mailed on December 27th of 1984.

Q. And were they mailed by your fulfillment house?

A. No, these were mailed by a letter shop that we hire to do our direct mail campaigns in Dallas.

Q. So they were mailed from Dallas?

A. Yes, that's correct.

Q. Were they mailed to persons (p. 216) throughout the State of Texas?

A. Yes, they were—only to people in Texas.

Q. But they weren't limited to a specific geographic area, were they?

A. Not within Texas.

Q. Okay, sir. You mentioned that there was a 17.3 percent decrease in response between the persons that answered the test panel and those that answered the control panel; is that correct?

A. Yes, that's correct.

Q. Okay. Is that a gross response rate or a net response rate?

A. That is a net response.

Q. Okay. Could you explain for the Court what a gross response would be, as opposed to the net rate?

A. Gross response denotes the number of people that send in the card, some being cash orders and some being bill me later orders or credit orders, as we call them. Net response is the number of cash orders plus the number of paid credit orders.

Q. Okay, sir.

(p. 217) A. Or in other words, the total number of paid orders that came back.

Q. There seem to be two differences on your test panel from your control panel. Could you refer to those exhibits, please, and I'll ask you, if you don't agree with me, there's a difference in price, of course, of 62 cents; is that correct?

A. That's correct. The 62 cents was the, at the time, five and an eighth percent sales tax added on to the $12.

Q. And of course, there's the notation there of the asterisks and then the notation of tax included at the bottom. Is that another difference?

A. Yes, the asterisk I referred to, yes.

Q. Okay. You were present at some depositions that were held during the course at discovery in this case where another test might have been had where the only difference was an asterisk that then referred you to a footnote that said "plus tax." Do you remember that?

A. Yes, I do.

Q. Okay, and there was a difference of—in response rates in that case, wasn't there?

(p. 218) A. Yes, the one that had the asterisk plus tax had a lower response rate than the one that did not.

Q. And if you'll remember, the price was exactly the same on both cards. It's just that it had an asterisk. The control panel and the test panel both had the same price. It's just one had an asterisk with the two words "plus tax"?

A. I believe that's correct.

Q. Is there any way for you to tell whether in your test panel, which you've got right in front of you—that test that you ran—whether if you had just raised the price by 62 cents and not included that asterisk, would that have affected the response rate?

A. It may have.

Q. Okay, and of course, I think it's been your testimony through—at least in depositions, that the group that you're after is a rather finicky group. The magazine

readers are a finicky group and that anything that you change in your control panel price or term or language has a tendency to affect their response rates. Isn't that a fair statement of what you (p. 219) said before?

A. I don't know if I would term them finicky, but I would say that people that respond to mail order—direct mail are primarily impulse purchasers. I mean, they want to make a quick decision, and anything that gets in their way of making that decision can significantly hinder response.

Q. And it's pretty hard—your job is relatively hard because you've got to try and read these people and get them to buy your publication, but you never know exactly what a particular language or term change is going to do to their response; is that correct?

A. Well, over time we develop theories about it, but that is why we do tests continuously.

Q. What I'm asking you is it's a difficult job to determine; right?

A. It's difficult, if you don't test. If you test each variable, you can always read the response scientifically.

Q. Okay, sir. Well, what's it—what would be the difference, if you hadn't included the asterisks and the words "price includes 62 (p. 220) cents sales tax"?

A. I don't know because I haven't—I didn't test it, except for this way.

Q. Okay, but from your experience in doing these tests, would it be possible for you to say, "Well, it would

be worth .3 percent or 1.3 percent" or some specific number?

A. I wouldn't hazard a guess because as you pointed out they are—it is difficult to read, unless you actually go through the tests.

Q. Okay, sir. Well, I want to—based on that I want to get into something else. You mentioned two things that, in your opinion as the circulation manager, are going to affect—are going to happen to *Texas Monthly*. One of them is that this represents a significant change. If you do this, it's going to represent a significant change in the readership population. Can you tell us exactly how many dollars less *Texas Monthly* is going to make from subscriptions, if it adds this language into its form—its basic subscription form?

A. I couldn't tell you that off the top of my head, but I believe that number has been calculated somewhere. Our expert witness or (p. 221) someone has that figure.

Q. Would you know if you changed the asterisks and you just raised the price by 62 cents what effect that would have?

A. I would think that a price increase would lower the response. From the readers' point of view, this sales tax is making it more complicated for them to subscribe, and magazine readers are price sensitive.

Q. Can you tell the Court exactly—

MR. GEORGE: I would like to let the witness finish the answer.

THE COURT: Let the witness finish.

THE WITNESS: Magazine readers are price sensitive, and by adding the 62 cents tax, it's going to have an affect (sic) to lower the response.

QUESTIONS BY MR. MENDEZ:

Q. Can you tell the Court exactly how many dollars that would mean in terms of subscription revenues?

A. No, as I said before, I don't have that figure off the top of my head.

Q. Okay, sir. Now, you mentioned that (p. 222) it would cause a disastrous result for the corporation, and of course, we're involved here in lawsuit where *Texas Monthly* must show injury. Do you think that this—the adding of these words requiring the collection of the tax would drive *Texas Monthly* into bankruptcy, let's say, or to seek the protection of the Court, in terms of its financial condition?

A. It could over time. I'm not going to guess at whether or not it would bankrupt the company, but I do know that it would put it in severe jeopardy, in terms of where it is today.

Q. Well, how long would it take for this to affect the operations of the company so that it could no longer operate effectively?

A. I haven't tried to make those calculations myself, but I believe Mr. Lepere has calculated some of those numbers.

Q. So when you say that this is going to have disastrous or severe consequences, that's just your idea as to what it's going to do to your subscriptions; is that correct?

A. Well, it's really looking at the notion of a 17.3 percent reduction in our circulation, which roughly translates into (p. 223) 40,000 subscribers. If you take those 40,000 subscribers away from our circulation, you end up with a significantly lowered rate base. If you end up with a significantly lowered rate base, you can charge significantly less money in advertising. So it has a compounding affect.

Q. But what I'm asking you is can you tell the Court exactly how much or when these things are going to happen?

A. How much?

Q. How much of an impact in dollars is this going to have on the corporation, let's say, by next accounting year-end?

A. As I said before, I believe Rick Lepere has calculated numbers to that effect.

Q. Okay. Now, has *Texas Monthly* continued to use these test panels subsequent to its tests which started in December of 1984?

A. Have we continued to use our control panel?

Q. Your test panel.

A. The one that adds the tax?

Q. Yes, sir.

A. No, I made the decision based on the results of this test not to continue to attempt (p. 224) collecting tax.

Q. You made the decision not to include a reference to taxes in your solicitation form by direct mail; is that correct?

A. Yes.

Q. Okay, and did you make any decision as to how to deal with that on insert cards?

A. We've decided not to mention the tax on any of our promotion pieces.

Q. And did you decide to do anything about sales or use tax collection in regard to your agent solicitations in the State of Texas?

A. No. We didn't decide to do anything. I mean, we enter into arrangements with them to sell subscriptions at whatever rate we give them. Let's say it's 12 issues for 11.97. How they deal with the tax issue I'm not aware.

Q. Okay, sir, and to the best of your knowledge, there's no reference to tax in the solicitation offer that they give the Texas residents?

A. I have not seen any.

Q. Okay, sir, and so isn't it —

A. Any reference, that is.

Q. Okay, sir. So then wouldn't it be (p. 225) fair to say that there's been no impact on *Texas Monthly's* rate base because, aside from this small test of 5,000 persons,

you haven't used this type of language anywhere else in your solicitation efforts?

A. Currently the mention of tax has not affected our rate base because we're not doing it for the express purpose that it would damage our rate base.

Q. Okay, sir. So there's no evidence at this point then, or you don't know of any actual loss that might have occurred up to this point on the rate base because of the affect of the tax on *Texas Monthly;* is that correct?

A. Well, I would consider this test as evidence that there is significant damage or could be significant damage if we were to implement this procedure or the procedure of mentioning tax on any of our promotion pieces.

Q. And what if you kept doing it the way you're doing it now?

A. If we kept doing it the way we did it now?

Q. Yes, sir.

A. Which is not mentioning tax?

(p. 226) Q. Exactly.

A. We would not be able to collect the tax.

Q. Okay. So is it then a business decision on the part of *Texas Monthly* not to include any language with respect to the sales or use tax in any of its solicitation materials?

A. At this time, that's correct.

Q. Okay, and it's a business decision, to the best of your knowledge, to calculate the tax in the manner that

Mr.—well, by backing into it by determining the number of magazines that you sold in Texas and the revenues derived therefrom?

A. Whatever method Mr. Gerhart explained is the method that we're using.

MR. MENDEZ: Thank you, sir. Pass the witness.

## REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE

Q. Mr. Childs, as I understand it, you're simply paying your gross receipts tax; is that right?

A. Effectively, yes.

(p. 227) Q. And you've determined that—on the basis of your test and your experience, that there's no way to collect the tax from the people who owe the tax, that is, the users?

A. That's correct.

MR. GEORGE: That's all of the questions I have.

## RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, Mr. Childs, what is a gross receipts tax?

A. What is a gross receipts tax?

Q. Yes, sir.

A. I believe that it's a tax off the revenues collected.

Q. Are you a lawyer, sir?

A. No, I'm not a lawyer.

Q. Okay. Have you ever seen any gross receipts taxes that are imposed by the State of Texas?

A. Have I seen any?

Q. Have you—do you know of any gross receipts taxes that are imposed by the State of Texas?

(p. 228) A. No, I do not.

Q. Do you know where the incidence of that tax might fall?

A. No, I do not.

MR. MENDEZ: Pass the witness.

MR. GEORGE: That's all of the questions we have.

THE COURT: You may step down.

THE WITNESS: Thank you.

## CORINA TIEMEYER

was called as a witness and, having been previously duly sworn, testified as follows:

## DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Corina Tiemeyer, 11711 Memorial Drive, No. 47, Houston 77024.

Q. And how are you employed?

A. I'm the associate publisher and general manager of *Houston City* magazine.

(p. 229) Q. Could you describe *Houston City* magazine for the Court, please?

A. It's a general interest magazine concerned with life in Houston.

Q. It is circulated to consumers, as opposed to business readers basically?

A. Yes.

Q. Is it a magazine appealing to the same kind of reader *Texas Monthly* appeals to only for Houston, as opposed to the whole state?

A. Yes.

Q. Can you tell the Court where it is printed?

A. It is printed in West Virginia.

Q. Do you circulate the magazine through the mail subscriptions?

A. Yes.

Q. Okay. Do you circulate over the newsstand, as well?

Q. Approximately what percentage of your total circulation is through the mail, and what percentage is on the newsstand?

A. 75 percent is through the mail. 25 percent is on the newsstand.

(p. 230) Q. All right, and in connection with those copies that you mail, are most of them to people in and around Houston?

A. Yes.

Q. How do you go about getting it printed and to the people in Houston? Is it printed in—where is it printed? I'll ask it that way.

A. You mean how does it get from the printer to Houston?

Q. Yes.

A. It gets trucked from the printer to the Houston post office, and then the post office mails it, and it goes to the subscribers in their home.

Q. Okay, and does the printer truck it from West Virginia to the post office in Houston?

A. Yes, he arranges for that.

Q. Do you—how do you go about fulfilling the subscriptions? Do you have a company that is in charge of maintaining your subscriptions and that sort of thing?

A. Yes, Fulfillment Associates, Incorporated.

THE COURT: Who?

(p. 231) THE WITNESS: Fulfillment Associates, Incorporated.

QUESTIONS BY MR. GEORGE:

Q. And where are they?

A. In New York.

Q. What was your employment before you went to work for *Houston City* magazine?

A. I was a vice-president of Bayland Publishing, which had two magazines—*Houston Home & Garden* and *Dallas/Fort Worth Home & Garden.*

Q. And what was your business before that?

A. I was in direct mail advertising for about 15 years.

Q. In your jobs with *Houston City* and with your prior employer, have you had occasions to deal with other fulfillment houses?

A. Yes, Neodata.

Q. Any others?

A. No.

Q. And where was Neodata?

A. In Boulder, Colorado.

Q. Have you done any—made any efforts to try to determine what affect (sic), if any, (p. 232) attempts to collect the sales tax would have on *Houston City* magazine and under its operation?

A. I did a direct mail test, which noted a sales tax a year ago.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 43 through 45 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Ms. Tiemeyer, can you describe for the Court how your company goes about making—sending direct mail solicitations to potential subscribers?

A. We rent the use of other people's mailing lists—other publications' mail-order companies. We merge purge the names. That means merge the names together and purge out the duplicate names. We select the lists by demographics, trying to find people that fit the profile of our readers, and then we mail packages to those people.

Q. About how frequently do you do that?

A. Twice a year.

Q. Okay, and do you regularly run tests to determine the effect of particular changes on your offer or the way your test package looks or (p. 233) other things?

A. Yes, always.

Q. And that's a regular part of your business?

A. Yes.

Q. And you said you ran a test in response to the effect of the sales tax in the fall of '84; is that correct?

A. December of 1984.

Q. Okay, and was that test run the same way the tests were run for your regular course of business?

A. Yes, it was.

Q. Okay. Can you describe how the test was run?

A. We Nth name selected a control panel.

Q. You're going to have to stop and explain what Nth name means.

A. Randomly selected names from our mailing lists the size of 400,000. We selected 10,000 randomly for the tax tests and 10,000 randomly for the control panel, control panel being the exact same mailing piece as the major portion of the mailing. We selected 10,000 and 10,000 because that would be an accurate test.

(p. 234) Q. Okay, and are the exhibits before you the copies of what you sent out?

A. Yes.

Q. Exhibit No. 45 and Exhibit No. 44?

A. Yes, they are.

Q. Okay, and these envelopes contain blanks in this window. Would the address of the person to who it's sent to appear in that envelope?

A. Yes, their name and address.

Q. Who would put the labels on?

A. The letter shop—the people that I would hire to actually do that mailing for us.

Q. Okay, and can you tell—describe or show the Court what the difference between the test that was your control test and the one testing for sales tax response is?

A. The mailing pieces are identical, except for the order card, which is the response vehicle. This is the part that the person would return to us saying that they wish to subscribe.

Q. Why don't you show it to him since he's the one that needs to see.

A. The only difference is that there's a little asterisk there, and down here that says (p. 235) "plus tax."

Q. Can you show the control card to show the contrast, and the control card is Exhibit No.—one of them has an asterisk that says plus tax and one of them doesn't?

A. That's correct.

Q. In the package of materials that were mailed, which contains some letters and other things, was there any other reference to taxes?

A. Yes, in the letter.

Q. Would you show for the Court the two letters and how they differ, and when you do that, refer to their exhibit number, if you would, please, for the record. There's several—there's a deposition exhibit and an exhibit—

A. It's 44D and 45D. It's the same type of thing. It's just an asterisk in one of the paragraphs next to the price, and then in the lower left-hand corner the asterisk again says "plus tax."

Q. Was there any difference in the kinds of people or the lists of people you sent out Exhibit 45, as opposed to Exhibit 44?

A. No, they were randomly selected.

(p. 236) Q. Now, what was the response difference of the orders that you got back?

A. The net response, which means the people that respond and pay for the subscription—the results show a 25 percent decrease for the test panel with the tax.

Q. Now, is the 25 percent decrease in the responsiveness to your direct mail solicitations important to your ability to survive as a viable economic entity?

A. Oh, absolutely.

Q. What—can you describe for the Court what economic effect that would have on the operation, if you were to continue only to have such a decrease in responses?

A. Well, the magazine publishing business is based on a rate base, which is guaranteed to our advertisers. In our case it's 60,000. We have to make sure we furnish 60,000 paid readers to our advertisers. In order to do that, we constantly have new subscription acquisition promotion. At the present time, that costs me a minus $20 a subscription. In other words, we lose money on every subscriber.

Q. It costs you $20 more to get a (p. 237) subscriber through the various direct mail packages than they bring in in subscription revenue?

A. That's correct.

Q. Okay.

A. So if I decrease my response by 25 percent, the cost to get those subscribers goes up in relationship to that. So it would be a very large economical problem for us.

Q. And the number of your—the rate base for your subscription rate base would go down?

A. Yes, I'd have to put out a lot more mail to make up those 25 percent of the people that I lost, and that would be very, very expensive.

Q. And what would be the effect of simply reducing your rate base?

A. We would lose advertising, and we wouldn't be able to charge our advertising rates.

Q. Is the rate that an advertiser pays based on the number of thousands of readers there are?

A. Yes, it's a cost per thousand.

Q. So if you have 25 less percent—(p. 238) you had 40 percent—40,000—a rate basis of 60,000, your price for a page of advertising would be reduced significantly?

A. Yes.

Q. Okay. Now, in connection with the—

MR. GEORGE: Well, first of all, I'll offer Exhibits 43—

MR. MENDEZ: No objection.

THE COURT: It will be admitted.

MR. GEORGE: —and 44 and 45, which have subparts A through D.

MR. MENDEZ: No objection.

THE COURT: They're admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, magazines are—are you familiar with magazines from out of state that are mailed to Houston residents?

A. I know of magazines that are mailed from out of state to Houston residents.

Q. And do you compete with those magazines in any way?

A. At times, yes.

Q. And do you compete for subscribers?

(p. 239) A. Yes.

Q. With those magazines?

A. Yes, I do.

Q. Now, based upon your experience in the industry and your experience—you lived in New York, did you not?

A. Yes, I did.

Q. And you worked there for 15 years in the direct mail publishing business; is that right?

A. Yes.

Q. Did the magazines that you're familiar with that are based in New York that are sent in to Houston collect sales tax from Texas readers?

A. Not to my knowledge.

MR. GEORGE: Thank you very much. That's all of the questions that we have at this time.

## CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Ms. Tiemeyer, do you have a sales and use tax permit? Does your corporation maintain a sales and use tax permit?

(p. 240) A. I don't know.

Q. Okay, and do you know whether or not you remit a Texas sales tax?

A. To my knowledge, we did.

Q. Okay, and do you know how they calculate—how your corporation calculates that tax?

A. From information gathered from our fulfillment company. That's how we paid it. We try collecting it through our billing series.

Q. You try doing what?

A. To collect the tax through our billing series.

Q. Okay. Do you know if your fulfillment house has the capacity to record whether or not sales tax was collected or use tax was collected on a specific magazine?

A. I believe that they do.

Q. What's the name of the company?

A. Fulfillment Associates, Incorporated.

Q. And that's in New York; right?

A. That's correct.

Q. Okay, and aside from this test panel that you are testifying to today, which is your Exhibit No. 44, have you ever included a (p. 241) reference to sales or use tax in any of these previous solicitations?

A. No.

Q. Okay. So do subscribers—to the best of your knowledge, do subscribers include or calculate the sales or use tax that's due and send it in along with their order form

to your fulfillment house, even though they don't have a reference to it or indication that sales or use tax is due?

A. The fulfillment—most of our orders come in as "Bill me." So a bill is then sent out, and our fulfillment company prints the amount of the tax on the bill so that the subscriber knows exactly how much he or she has to pay.

Q. And do you know or do you have any reason to know whether or not the fulfillment company receives or does not receive the amount of taxes—the amount of the subscription that's billed?

A. Our corporate controller in Dallas has been keeping track of this, and approximately 50 percent of the subscribers do not pay the sales tax.

(p. 242) Q. Okay, and does your magazine—does your publisher make a business decision not to stop sending the magazine to those persons that didn't remit the tax?

A. I'm sorry. Could you repeat that?

Q. Does your magazine continue to— does your publisher continue to send copies of that magazine to persons that did not remit the use tax?

A. Yes, we have no choice but to do that.

Q. Why don't you have a choice?

A. Because we cannot afford to lose the paid subscriber and have our rate base suffer.

Q. Is it your understanding that the corporation then picks up the sales or use tax for that person that didn't remit it and remits it to the State for them?

A. That's my understanding.

Q. And you're not going to send out a letter, are you, to that person who forgot to send you the 60 cents or the 50 cents to tell them to send that in to you?

A. We have not done that so far.

Q. From your business experience, would (p. 243) that be an economical way to handle the noncompliance by those persons?

A. Probably not but I don't know.

Q. Okay, ma'am, could you explain what the demographics of the group are—the profile of the group that you tested in this testimony that you've given today?

A. Yes. Our average age of our reader is 38 years old. Half of our file is male and female. The average income is about $55,000. About 80 percent of our readers are in top management positions. 82 percent have either gone to or completed college. That's the type of demographics that we look for.

Q. And if I told you that I had a list to rent to you and it had a group of persons on it whose median age was about 40 years and they made over $40,000 a year and half of them were men and half of them were women and most of them are married and most of them have college educations or graduate work, would that be a list that you might be interested in, in order to subscribe to —I mean, to approach them for sales of *Houston City?*

A. I would be interested in testing (p. 244) that list, yes.

Q. And would you say that if somebody sold subscriptions to that group that they were—here in Texas and maybe persons that might be located in Houston with those demographic profiles that they would be competing with you for sales of magazines?

A. I'm sorry. Could you repeat that? It was a little long.

Q. I don't know if I can. If I told you that I was selling a magazine to somebody in Houston that had that demographic profile, which I just described—you know, 40 years and all of that, would you have a reason to believe that I'm competing with you for that person in the magazine business?

A. If your editorial content was the same as mine, yes.

A. And to the best of your knowledge— well, are you familiar with *Texas Monthly?*

A. Oh, very, yes.

Q. Okay. Would you consider that to be a magazine whose editorial content would be the type that you might compete with?

A. Editorially and advertising-wise (p. 245) *Texas Monthly* is a competitor of ours.

Q. Okay. Ma'am, why did you pick 10,000 persons?

A. It's a good test size.

Q. Is a bigger test size any better?

A. Not on a 400,000 mailing list, no.

Q. Okay. Well, what's a good universe to use of —what would be the minimum size of a mailing list that you would use as a universe for some test like this?

A. You could do it with 200,000 names and test 5,000 of them. It depends. I mean, it's a local market. We don't have 2,000,000 names to send to.

Q. Okay. Does the number of names in the universe and in the actual sample tend to increase the accuracy of your estimate or not?

A. Say it again.

Q. Does a larger universe and a larger sample in your tests indicate a more accurate figure or result?

A. No.

Q. And why is that?

A. Because it's proportionately a correct testing group.

(p. 246) Q. So you could test two people, and if you got one response, that's as good as 10,000 and if you got, you know, a thousand responses?

A. No, it would not be the same, if you were just testing two people.

Q. Okay. Well, what is a good test size is what I'm asking you from your experience?

A. 10,000 test pieces is an accurate sampling to get accurate results.

Q. In your tests what was the difference between the person—in response rate between the persons that responded to the test panel and those that responded to the control panel?

A. May I see the exhibit?

Q. It's Exhibit No. 43, and I don't have it. I mean, I've got a copy, but I don't have it here.

(At this time there was a brief discussion off the record.)

QUESTIONS BY MR. MENDEZ:

Q. Do you have that exhibit in front of you now?

A. Yes, I do.

(p. 247) Q. Okay. Did you conduct that test?

A. Yes, I did.

Q. What was the percentage difference in the response rate between the persons that responded to the test panel and those that responded to the control panel?

A. The net difference was 2.9 percent—2.9 percent, which is a 25 percent decrease.

Q. So 25 percent less people responded to your test panel than to your control panel?

A. Yes.

Q. Okay, and now, that's your net response, is that correct?

A. Yes, that's correct.

Q. What was your gross response?

A. The gross response—the difference was .18, which is an eight percent decrease.

Q. Okay. Was this a cash offer, or this was a credit offer?

A. It was a credit offer.

Q. Okay. Do you have any—what is the explanation for—if you know and from your experience in this industry, why there's such a difference between gross responses and net responses?

(p. 248) A. Well, in general this was a first issue free offer, and it was also a credit offer. So usually you'd get fewer people paying than responded to begin with. In this particular case, I believe the greater decrease between gross and net was due to the bills going out and showing the tax on it.

Q. Okay. What—is there a different response rate for different types of terms and prices?

A. Yes, a hard offer, which is not a first issue free, has a lower gross response and a higher net response.

Q. What if you had an issue—an offer which was two free issues of the magazine plus a term of 12 months, if you pay cash right now, or you'll just get the 12 months, if you buy it for credit?

A. You'd have—well, say that again. If it was a cash—

Q. Are you familiar with the test that *Texas Monthly* conducted that's similar to the one that you did?

A. No, I'm not.

Q. Okay. If I told you that I was (p. 249) going to make an offer that was for a term of 14 months and that I'd give the person two free copies if he sent me the cash right away and then if he did want to pay cash that he could have 12 issues for that same price, do you know that kind of a test—I mean, that kind of a term would have a similar response to the one that you have here in your test?

A. If what you're saying is that they get two issues extra but they must send the cash with the initial order, they would have a lower gross response and a very high net response because the cash would have been received up front.

Q. People tend to be less responsive to cash—to sending in cash?

A. That's correct.

Q. Okay. About how many of these tests have you conducted in your career?

A. Just tests—not tax tests; correct?

Q. Well, just different terms and prices and things like that.

A. I'd say several hundred.

Q. Okay, and is that—you were in the direct mail business for a long time. Is that (p. 250) something that's normally done by direct mail outfits?

A. Yes.

Q. And you take a control panel and then you run a test panel against it on a certain sample of people?

A. One or several tests.

Q. Okay. How long have you been with Southwest Media?

A. A year and a half.

Q. Now, ma'am, does your magazine sell advertising space?

A. Yes, it does.

Q. Okay. Does it compete for advertisers with *Texas Monthly*?

A. Yes, it does.

Q. Okay, and is it a—was it a business decision of the corporation to use this reference to tax in its normal control panel for solicitation after you ran this test?

A. After we ran the test based on the results, we decided not to put any reference to sales tax on our subscription acquisition promotion pieces.

Q. Have you ever used that—aside (p. 251) from this particular test, have you ever made references to the use tax or sales tax collection in any of your solicitation material?

A. No, not other than this.

Q. So this is the only experience that you have with respect to the effect on your circulation of putting those words in?

A. That's correct.

Q. Okay, and you mentioned that this would have an economic effect on your corporation. Can you tell the Court exactly how much money Southwest Media would lose through the end of this fiscal year, if it used that type of a—that type of language in its solicitation?

A. No, I could not give you a dollar amount off the top of my head, but it would be proportionate.

Q. And in fact, it's not going to lose any money because they're not using that type of a solicitation device, are they?

A. No.

Q. Okay, and it's a business decision of the company to not attempt to collect a tax from the individuals; is that correct?

(p. 252) A. No, that's not correct. We attempt to collect it via our billing series.

Q. Okay. So to the extent that purchasers buy it on credit and that you can get the money from them when you send them the bill, then to that extent you attempt to collect it?

A. That's correct.

Q. Okay. If a person does not comply with your initial bill, then you don't stop sending him the magazine. You just eat the tax?

A. That's correct.

Q. Okay. From your experience in the direct mail business and in the magazine business, do you know how many fulfillment houses there might be in the country?

A. No, but I'd say at least 50.

Q. Okay. Do you know which ones—any of them that might be able to calculate or incorporate tax calculations into—tax collection mechanisms into their computer programs?

A. I don't know of any that have that. I'm sure they could do it.

Q. But you've mentioned that your fulfillment house in New York can calculate that (p. 253) and indeed does calculate that for your company; is that correct?

A. That's correct.

Q. Okay, and what is the percentage of income from advertising that your company experiences, as compared to the total revenues of the—from that magazine?

A. I'd say it's about seven times as great—the advertising revenue is seven times as great as the subscription revenue.

MR. MENDEZ: Pass the witness.

## REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Tiemeyer, let me get something straight. You send out these solicitations and ask people to buy on credit; is that correct?

A. That's correct.

Q. And you have been sending out bills to the people that show—what's your basic subscription rate?

A. $15.

Q. —$15, and then they add—plus the tax?

(p. 254) A. That's correct.

Q. Plus whatever that is—60, 70 cents, 75 cents tax or something like that?

A. Thereabouts.

Q. And you told the Court that 50 percent of the people refused to pay the tax?

A. That's correct.

Q. They remit the balance and don't pay the tax?

A. That's right.

Q. And that's been going on for a year?

A. That's correct.

Q. Given the fact that your subscription revenue is seven times—I'm sorry—your advertising revenue is seven times your subscription revenue, is there any way you can economically force somebody to pay the tax, if they choose not to?

A. No.

Q. And 50 percent of the people simply don't—refuse to pay the tax?

A. That's correct.

Q. Do you know whether that is affected by the fact that they don't have to pay the tax if they subscribe to magazines like *Reader's* (p. 255) *Digest* and those kinds of magazines?

A. I don't know.

MR. GEORGE: That's all of the questions I have of this witness. Thank you very much.

## RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. I have a couple of questions. Ms. Tiemeyer, has your corporation been involved in any lobbying efforts with the Texas Legislature to try to amend this statute so as to correct this supposedly—

THE COURT: This is interesting, but it looks like that's irrelevant.

MR. GEORGE: I was going to object on that basis. It's irrelevant and—

MR. MENDEZ: No further questions.

MR. GEORGE: Your Honor, I have a witness by deposition, a Mr. Bullock, and we can put that on in the federal court manner by simply referring you to line and pages and having you read it, if you wish, or I can have it read question and answer at your—since (p. 256) this is a bench trial, whichever way you want to do it.

THE COURT: It might be quicker if we read it and I listen to it. That way—

MR. GEORGE: Okay.

THE COURT: Are you offering all of it?

MR. GEORGE: No, sir, I'm offering only—or most of it but it's—it will take a few minutes, and can I—

THE COURT: If you're offering all of it, I would accept it that way, and I'll read it, but if you're going to pick and choose, I'd rather you—

MR. GEORGE: Okay. I have marked it—part of it. Can I borrow your copy? My other copy is at the—

MR. MENDEZ: Why don't we just agree to introduce the whole deposition? I don't have a problem with it.

MR. GEORGE: Well, you asked the questions, and some of your questions aren't admissible, Mr. Mendez.

MR. MENDEZ: Why don't you— (p. 257) well—

MR. GEORGE: I'll just read it to the Court.

THE COURT: All right.

MR. GEORGE: Beginning on page four, questions by Mr. Mendez. This is the deposition of Scott Bullock taken on January 28th, 1986 in Austin, Texas at 2300 InterFirst Tower, offices of Graves, Dougherty, Hearon & Moody. The witness was sworn.

THE COURT: I don't guess I've got it up here.

MR. GEORGE: I'm going to give him this one and let you and I read that one.

Beginning on page four, line two. Question by Mr. Mendez.

"Please state your full name for the record, sir.

"Answer: Scott Arthur Bullock.

"Question: And where do you reside?

"Answer: In Dallas, Texas.

"Question: And with whom are you employed?

"Answer: Southwest Media Corporation.

(p. 258) "Question: And could you give us the business address of that?

"Answer: 3988 Northcentral Expressway, Suite 1200, Dallas, Texas 75204."

Stop on line 12, page four. Go to line 17, page five. Question again by Mr. Mendez:

"What is your position with Southwest Media Corporation, sir?

"I'm circulation director for *D Magazine*.

"Question: Is that a publication that is published by the corporation?

"Answer: That's correct.

"Question: And that's *D Magazine*?

"Yes.

"And how long have"—

"Question: And how long have you been circulation manager or director for that entity?

"Answer: I have been circulation director for nine months.

"Question: And what are your duties as circulation director for *D Magazine*?

"Answer: You could—could you be more specific?

"Question: Well, what do you do in your (p. 259) job as circulation director for the publication? What are your responsibilities?

"Answer: My job is to sell subscriptions and to service subscriptions.

"Question: And do you do this as an employee of Southwest Media Corporation?

"Answer: Yes.

"Question: Are you an officer or director of that corporation?

"Answer: No, I'm not.

"Question: Are you just an employee that works with *D Magazine*?

"Answer: That's correct."

End line 21, page six. Go to line five, page seven.

Question by Mr. Mendez:

"How long has Southwest Media Corporation published D—the magazine D?

"Answer: I believe 11 years.

"Question: And what type of articles or materials are contained in the general sense in this publication, *D Magazine*?

"Answer: Mostly articles that pertain to living in Dallas.

"Question: And that format has been (p. 260) maintained throughout the 11 years, to the best of your knowledge?

"Answer: Yes, sir.

"Question: How long have you been with Southwest Media Corporation?

"Answer: I already answered that—nine months.

"Question: So you didn't work for them prior to the time that you had worked as circulation director?

"No.

"And where were you employed prior to that time?

"I was employed by Xerox Corporation.

"And—Question: And they are in Dallas?

"Answer: That was in New York.

"Question: And what was your position there?

"Answer: I was circulation promotion coordinator for four trade titles.

"Question: And what were those publications?

"Answer: *Publisher's Weekly, Library Journal, School Library Journal,* and *Small Press* magazine.

(p. 261) "What type of profession or trade uses those types of publications?

"Answer: The publishing community and libraries principally.

"Question: What is the circulation of *D Magazine*?

"Approximately 80,000.

"Question: And I would say this is the current—this would be the current circulation of that magazine?

"Answer: That's correct.

"Question: Do you have occasion to review ABC reports or Audit Bureau of Circulation reports with respect to the circulation of *D Magazine*?

"Answer: Yes, I do.

"Would you identify for the Court approximately how many or what percentage of those 80,000 publications are sold outside the State of Texas and what percentage is sold within the State of Texas?

"Answer: Outside the State of Texas approximately one percent—less than one percent.

"Question: The rest of them all in Texas?

(p. 262) "Answer: That's correct.

"Question: Can you identify for the Court what percentage of these magazines are sold by subscription, as opposed to sold to newsstands or other retailers of magazines?

"Answer: Percentages?

"Question: Yes, sir.

"Answer: Approximately 20 percent are sold that are not subscriptions.

"Question: So 20 percent of them may be sold to other retailers that may sell them over the counter? Is that a fair statement?

"Answer: Approximately.

"Question: So that 79 or 80 percent would be persons that subscribe to your company for issues of the magazine?

"Answer: Approximately."

End page nine, line 24. Go to line—page 13, line 11.

"Question: How could you describe how your direct mail promotion scheme made it to a potential purchaser, if it did?"

THE COURT: What page are you on?

MR. GEORGE: Page 13, line (p. 263) 12, again questions by Mr. Mendez.

Question by Mr. Mendez: "Now, would you describe how your direct mail promotional scheme made it to a potential purchaser, if it did— what their use tax liability would be for the purchase of the magazine, if you have done that?

[sic] "I'm not sure I understand the question.

"Question: I assume that by direct mailing you are sending a particular subscriber a letter saying these are the reasons why you should subscribe to my magazine, and here is a price for you to buy it at. Is that a fair statement?

[sic] "Yes."

An objection by Mr. George: "Are you asking about the test that involves a reference to sales tax and the one that didn't involve sales tax?"

Interchange by Mr. Mendez and Mr. George. Skipping to—on page 14 to line ten. Question by Mr. Mendez:

"In using these various solicitation schemes, have you and your company made a test to determine what the effect would be of identifying to the taxpayer the need to remit (p. 264) use tax for the purpose of a subscription to *D Magazine*?

"Answer: We have made a test regarding sales tax.

"Question: Could you explain for the Court how that test worked?

"Answer: We mailed a subscription package to a list of lists, and the test was conducted in such a way that we mailed a certain number of packages with one offer in it, and we mailed the same package with the same offer, the same term, same price, but we mentioned sales tax in it, to determine if by mentioning sales tax it would have a positive or negative effect on a subscriber's decision to purchase the magazine.

"Question: And what constituted this solicitation package or this promotion package? Could you describe what documents would have been included in it?

"Answer: Yes, there is a carrier envelope. There is a postage paid return envelope. There is a letter, and there is an order card.

"Question: How was the subscription (p. 265) price offer relayed? Did it say something like 12 issues for eight plus tax—$8 plus tax or something like that?"

Interjection by Mr. George, "Do you have the cards with you?"

"The witness: Yes, I brought samples with me to be entered in—into. This one here is one that we call control panel, and that has been proven, over time over a series of tests to be one of our most successful approaches, and this one is where we mentioned again that the price being the same, the term being the same, but there is an asterisk that says 'plus sales tax,' " and when I'm going —so we can go through this in orderly fashion I'm going to have the court reporter mark both of these documents as Exhibit 1—or Bullock Exhibit 1 and Bullock Exhibit 2. At this point I will remove from this deposition transcript Bullock Exhibit 1 and Bullock Exhibit 2 and ask our court reporter to mark them as exhibits here.

(At this time the instruments referred to were marked as Plaintiff's Exhibits Nos. 46 and 47 for identification.)

(p. 266) MR. GEORGE: Going on, page 16. Questions by Mr. Mendez:

"Now, sir, we have marked for your deposition Exhibit 1. Could you identify that document for the Court? That is the control panel."

MR. GEORGE: I'll now offer Plaintiff's Exhibit 46.

THE COURT: Admitted.

MR. MENDEZ: No objection.

MR. GEORGE:

"Question: Is that an item that was included in the subscription package that you just testified about?

[sic] "Yes.

"Question: And is that particular exhibit the one that included tax or not—or not?

[sic] "That is—that is one that does not include tax.

[sic] "Now, to how many persons—potential subscribers was this document sent?

"Answer: 25,000.

[sic] "And from what type of list or from what list did you derive the name—the names of the (p. 267) 25,000 persons to whom Bullock Exhibit No. 1 was sent?

"Answer: There is a list of approximately 36 different lists—36 to 40 different lists that we used.

[sic] "And are these lists that are maintained by Southwest Media Corporation?

"Answer: No.

[sic] "Who owns or has custody of these lists?

"Answer: Various magazines.

"Question: Since they were in the custody or ownership of various magazines, how did you get access to them so that you could get addresses to mail that to?

"Answer: We rented them.

[sic] "Was there—was the mailing conducted by your office?

"Answer: Yes, it was.

"Question: Were all of these 25,000 persons that were derived from the list that were rented located in Texas?

"Answer: Not necessarily.

"Question: Could you describe for the Court what geographical area these people might have been located in?

(p. 268) "Answer: Are we talking about the potential recipients, or are we talking about the companies?

"Question: Well, the testimony has been that you had 25,000 mail-outs of Bullock Exhibit 1 to persons whose names and addresses showed up on the list, and what I'm interested in, sir, is do you have a way of knowing whether the 25,000 persons to whom these publication subscription offer was mailed were located in Texas or not?

"Answer: Yes, absolutely.

"Question: And you say that most of these people were in Dallas, Fort Worth area?

"Answer: Yes.

"Question: What else went along with Bullock Exhibit 1? If you have anything handy, did you bring anything else that was included in the subscription package that went with Bullock Exhibit 1?

"Answer: No.

"Question: So it included a letter explaining the offer, I gather; is that correct?

"Answer: That's correct.

"Question: Did the letter include any (p. 269) paragraph or sentence regarding the liability or non-liability of the user for sales tax and your responsibility for collection—collecting that use tax?

"Answer: In regard to Exhibit 1?

"Question: Yes, sir.

[sic] "There was no mention of sales tax.

[sic] "So there was no mention of the applicable sales or use tax in any part or any narrative in the mail-outs that went out to the 25,000 people that included Bullock Exhibit No. 1?

"Answer: No mention of sales tax.

"Question: Mr. Bullock, I hand you what has been marked as Exhibit No. 2. This is the one that is identical to Bullock Exhibit No. 1, except that it had plus sales tax asterisk on it?

"Answer: That's correct."

MR. GEORGE: I'll offer Exhibit 47, which is the same document referred to in the deposition as Exhibit 2 —Bullock Exhibit 2.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Now, (p. 270) beginning on page 19, line eight again continuing on that page.

"Question: And did you mail out to 25,000—and did you mail out to 20,000 persons also?

"Answer: No, we mailed it to 10,000.

"Question: And were these 10,000 persons derived from your list of lists?

"Answer: The same list as in Exhibit 1.

"Question: But I gather that you didn't send one of these—one of each package to each individual? You wouldn't do something like that? It was different individuals that it was sent to; is that correct?

[sic] "That's correct.

"Question: Now, were these people— these persons also the same—in the same geographical area as the 25,000 persons that was on Exhibit No. 1?

"Answer: Yes, they were.

"Question: Is there a specific reason why only 10,000 persons were contacted, as opposed to 25,000 persons?

"Answer: No.

"Question: Was there a recordation by (p. 271) your company—by your corporation or by persons to your corporation of responses to the package—the packages that are included in Bullock Exhibit No. 1?

"Answer: I'm sorry. I don't understand the question.

"Question: Did someone in your company maintain a list of how many people responded to the promotional package that included this Bullock Exhibit No. 1?

[sic] "Yes.

[sic] "And what were the results of that exercise?

[sic] "We received 506 gross responses.

"Question: To the 25,000 mail-outs?

"Answer: That's correct.

"Question: Did you calculate what percentage that was of the total?

"Answer: That was approximately two percent.

"Question: Is that particular response—well, let me ask it this way: Was there any change in the rate in previous offers that might have been made of the magazine in this particular promotional scheme?

(p. 272) "Answer: I don't understand the question.

"Question: Was there a change in the rate from previous subscription rates, if we are looking at Bullock Exhibit No. 1 and it says here that you can get 12 issues for 8.95; is that correct?

"Answer: That's what it says.

"Question: Is that the same subscription rate that might have been offered on previous promotional schemes that would have attempted to sell this magazine?

"Answer: Yes.

"Question: So there wasn't any change in the price? It was just a mail-out at the same basic price or offer that you make; is that correct?

"Answer: That's correct.

"Question: Now, is the two percent response—well, you mentioned that it was a gross response. I gather then that there was some deduction from that? What does that mean?

"Answer: Some people pay their bills and some people don't.

"Question: Does the gross response represent a meaningful measure for your (p. 273) publication of how many—of what the response is to the solicitation scheme?

[sic] "Yes, it does.

"Question: So two percent that in—so two percent that in line with your previous experience as to how many people subscribed out of a total solicitation offer?

[sic] "That's in line.

"Question: That's pretty normal; is that correct?

"Answer: Yes.

"Question: Now, was there a similar cataloging of the results of solicitation efforts that are covered by Bullock Exhibit No. 2 or that included Bullock Exhibit No 2?

"Answer: Yes.

"Question: And can you explain for the Court what your gross response was?

[sic] "For Exhibit 2?

"Question: Yes.

"Answer: The gross response was 117 orders, and the gross response percentage response was 1.1 percent.

[sic] "Was there a net response rate on that on Exhibit 2?

[sic] (p. 274) "Yes, that was calculated. Yes —

"Answer: Yes, it's .9 percent.

[sic] "And what was the net response rate on Exhibit 1?

[sic] "On Exhibit 1 it was 1.1 percent."

Stop. Go to page 23, line seven. Questions by Mr. Mendez:

"I want to go back to this experiment. I gather you don't normally do this type of solicitation differentiation; is that correct? You can't—you don't usually break down your solicitation efforts into various categories and see which one works better?

"Answer: Yes, we do.

"Question: Do you do that pretty regular?

"Answer: Yes.

"Question: And what other types of situations have you tested in this manner?

"Answer: Well, we test different packages against each other. We didn't do that in this case. We test different lists. We test different terms, meaning 12 issues, 14 issues, 16 issues. We test different price—8.95, 9.95, 10.95.

[sic] "And you had to conduct a test like this (275) before for your corporation; is that correct?

[sic] "Yes.

"Question: Does the management of Southwest Media Corporation, in deciding who might be potential subscribers to *D Magazine*, target a specific group of people—persons with a specific demographic profile?

"Answer: Yes.

"Question: If you could generalize for the Court, what type of demographics would describe the person the management of Southwest Media Corporation would target as a buyer?

"Answer: Someone who is educated.

"Question: Any other criteria?

[sic] "Age approximately 36 to 44, attended college.

"Question: Any criteria regarding how much money they make or not make?

"Answer: Anywhere from 25,000 to a million.

"Question: What efforts does Southwest Media Corporation go through to determine whether or not a particular list contains names of persons that meet the demographic requirements?

(p. 276) "Answer: We work very closely with professional list brokers who, like stock brokers, are well versed in the list business and provide data on the subscriber files.

"Question: So if you say you want a list of college graduates that are 36 to 44 that make incomes over $25,000—25,000, it's possible to go out and buy that from a professional list broker?

"Answer: It's possible.

"Question: And Southwest Media does this on a regular basis?

"Answer: We do things like that.

"Question: Would the persons that were contacted in this test—35,000 persons that were contacted on this test, which you have been giving testimony about this afternoon—would they be characterized as persons that meet these demographic requirements?

"Answer: I hope so.

"Question: I'm trying to be fair in my questioning. Would it be fair to say that you wouldn't have wasted your time mailing to people who didn't fit within these demographic requirements?

(p. 277) "Answer: That's true.

"Question: There are certain costs that go with this, and you are trying to get a certain response rate and that —and you wouldn't waste your time giving it to persons that wouldn't respond?

"Answer: We would test it but generally speaking we would not waste our time.

"Question: Sir, in your experience in previous tests, let's say, on price differentials—charging a different rate —an increase in price or decrease in price or testing for the responsiveness to that, would the number of persons have been similar to this?

"Answer: I'm sorry. I didn't catch that.

"Question: What I'm asking is is the size of the group that you test, 35,000, a normal size of a group—normal size of a group to test in a situation where you are testing for price differentials?

"Answer: Oh, yes.

"Question: Would it be similar for term differentials?

"Answer: Yes."

Continuing on page 26 with(p. 278) line 18.

"Question: Are there any situations that you can think of where you would use a test group of this size?

"Answer: There are many situations in which—

"Question: Where you would not use a test group of 35,000 persons or so to figure out what the responsiveness would be to a particular specific type of solicitation scheme?

"Answer: No, that size of 10,000 or more is generally statistically valid." Valued, I think it is. I think that's a misprint, but in any event—

"Question: And there again there is no basic—can you identify any reason why you tested less persons with a card that was Bullock Exhibit 2, as opposed to the persons that got Bullock Exhibit No. 1?

"Answer: No, I can't.

"Question: Did you make that decision, or did someone else in the firm make that decision?

"Answer: I did not make that decision."

Skipping to line 24 on (p. 279) page 27. Question by Mr. Mendez:

"Do you know—how long does a test like this take to perform? In other words, if you send out the cards today, when do you stop measuring responsiveness?

"Answer: We never stop measuring.

"Question: Do these have an expiration date on them?

"Answer: No, they don't.

"Question: So that you might still be getting responses to that particular direct mail offer that was issued in January of 1985?

[sic] "It's possible but not probable.

"Question: In your experience in the circulation department, about how long would it be reasonable after you sent out a direct mail scheme like this to still consider to be receiving responses from that?

"Answer: I would say one year.

"Question: Is this price still the same?

"Answer: Of what?

"Question: Well, Bullock Exhibit 1 indicates that for a term of 12 issues the basic subscription offer rate is 8.95. Is that still the rate that you offer the rate on?

(p. 280) "Answer: That is one of the rates.

"Question: Different solicitation schemes have different prices?

"Answer: That's correct.

"Question: Are you aware of any solicitation schemes that are offered for the 12-month term at a rate higher than that?

"Answer: Yes.

[sic] "Do you know if that might have been tested to determine the public's responsiveness to that offer?

"Answer: Yes.

"Question: Do you have any results of what affect the different rate had on responsiveness?

"Answer: I do not with me.

"Question: Can you tell the Court generally what that effect was?

"Answer: The higher the price the less likely someone is to buy it.

"Question: And you—and are you familiar with the manner in which Southwest Media Corporation reports and remits the sale or use taxes to the Comptroller of Public Accounts?

"Answer: I do not. That's a question (p. 281) for our Comptroller.

"Question: And do you have anything to do with receiving or recording offers, acceptances of your solicitation offers from the public?

"Answer: I am not sure I understand your question.

"Question: In other words, once you sent the package out, which included Bullock 1 or 2, do you have any

responsibility in the corporation for getting back the responses and recording them anywhere?

THE COURT: Are you getting a little thirsty? We can stop, if you want to. I'm not—you know, it's—I can go a little bit longer. Whatever you—

MR. GEORGE: Why don't—can we do ten minutes to see if I can finish this today so I don't have to start with it in the morning?

THE COURT: Sure.

MR. GEORGE: Beginning I think, on—may I sit down?

THE COURT: Sure.

MR. GEORGE: Beginning on (p. 282) page 30, line one.

"Question: In other words, once you sent this package out, which includes exhibit—Bullock's 1 or 2, do you have any responsibility in the corporation for getting back the responses and recording them anywhere?

"Answer: Yes, for testing purposes.

[sic] "Is that the reason you would use it or just general business purposes?

[sic] "Both.

"Question: So these responses for persons that want —say, the 506 people that were gross responses to the 25,000 in mail-out—did those come directly to your office?

[sic] "Yes.

[sic] "And what did you do with them?

[sic] "They are sorted and counted and then mailed out to the fulfillment house for final processing.

"Question: And the fulfillment house would then take care of making sure these people get the magazine?

"Answer: They are responsible for inputting the data into a computer system and producing labels that ultimately are put on the (p. 283) magazines so that they can be shipped.

"Question: But you have no responsibility for recording the revenue that may accompany an acceptance of the offer?

"Answer: I am not really sure I understand that question.

"Question: Okay. If you get these 506 responses back to your office, would my money accompany those in payment for the subscription?

"Answer: Would the money accompany?

"Question: Yes.

"Answer: Sometimes.

[sic] "And what's your responsibility with respect to recording that on the books of the corporation, if you have any responsibility?

[sic] "As far as accounting purposes, I have no responsibility.

"Question: So you have—so you just ship it over to the cashier or something like that?

"Answer: It's shipped out to the fulfillment house who then processes it.

[sic] "And who is the fulfillment house for Southwest Media Corporation?

"Answer: Fulfillment Associates, (p. 284) Incorporated.

[sic] "And where are they located?

"Answer: Farmingdale, New York.

"Question: In the course of your job as circulation director for *D Magazine,* do you have any knowledge as to how Fulfillment Associates, Inc. records—you know, well, records the use tax or sales tax that may be applicable to the sale of *D Magazine?*

"Answer: I do not."

Continuing with Mr. Mendez' questions on page 32, line 11.

"We are back on the record, sir. We have a question of value, and it's your business. So we really don't understand how your business works, but in arriving or compiling this list for 25,000 persons that you sent Bullock Exhibit No. 1 to, did you buy up lists or parts of lists that were owned or you rented them from your—from other individuals or other companies so that you got up to a total number of 25,000 names to mail it out to, or did you buy some larger quantity of lists and then randomly take names out of there that you might send the promotional scheme to?

(p. 285) "Answer: We rent lists to arrive at a certain gross quantity. Then on a random, what we call, Nth name selection, a random selection is then pulled from each of those lists to compose the test scheme."

Going to page 35, line 15.

"Question: And do you have an opinion from your review of this test as to whether or not it would have affected the company in some way?

"Answer: Yes, I have an opinion.

"Question: And what is that?

[sic] "My opinion is that the mention of an additional cost in the form of sales tax has a negative impact on a subscriber's decision to buy the publication.

"Question: Do you know what the management of Southwest Media Corporation did in response to the results of this test?

[sic] "What they did with it?

[sic] "Did they use them in setting up their business operations for *D Magazine* or any other magazine in Texas?

[sic] "I'm not sure I understand the question.

"Question: As a result of the experience (p. 286) that are generated by this test, do you know if Southwest Media decided to include this as a regular part of their package—the asterisk with the plus tax included or whether to eliminate it from all promotional schemes?

[sic] "I only know in regard to *D Magazine*.

[sic] "Okay, sir, and what was the management's decision?

"Answer: The management's decision was that because it had a negative affect on the subscriber's decision whether or not to purchase a publication to not mention sales tax.

"Question: Do you know how Southwest Media Corporation has decided to handle the reporting and remitting of the applicable sales and use tax for *D Magazine?*

"Answer: That's a question for the Comptroller.

"Question: So you have no knowledge right now of how Southwest Media calculates and reports taxes to the Comptroller?

"Answer: No, that's a question for the Comptroller."

Questions on page 37, line seven by Mr. Mendez:

(p. 287) "Sir, in the course of the deposition you have been referring to a document which you have with you, which I assume is a summary of the results of your experience, is that correct, regarding this test?

[sic] "Yes.

[sic] "Can I look at it?

[sic] "Absolutely."

Questions by Mr. Mendez, page 37, line 16:

"We are back on the record, sir. We have now had marked as a document, which you have read, Bullock Exhibit No. 3."

(At this time an instrument was marked as Plaintiff's Exhibit No. 48 for identification.)

MR. GEORGE: That document is now marked Plaintiff's Exhibit 48.

The answer to the previous question:

"It's just a brief summary of the results of the campaign in question and"—

The next question: "And did you prepare this document yourself?

[sic] "Yes, I did.

(p. 288) MR. GEORGE: I will offer Exhibit No. 48 —Plaintiff's Exhibit 48.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Turning to page line—I'm sorry—43. Questions by Mr. George:

"What was the difference in the response between the test panels, Bullock Exhibit No. 1 and Exhibit No. 2?

"Answer: The difference is that on Exhibit 1 we did a two percent gross response, and on Exhibit No. 2, we did a 1.1 percent gross response, and in terms of net response on Exhibit 1, we did a 1.1 net response, and on Exhibit 2, we did a .9 percent net response.

"Question: I noticed on Exhibit 3 you have a different—the different decrease in response of 18.2 percent?

[sic] "That's correct.

"Question: Is that a significant decrease in response rate for packages that are identical except for the mention of sales tax?

"Answer: It's very significant."

MR. GEORGE: That's the (p. 289) end of the questions and answers I have out of this deposition.

THE COURT: All right. We'll recess then until 9 o'clock in the morning.

(At this time the proceedings were adjourned until 9:00 a.m. on February 4, 1986.)